



THE RENEWAL OF TRUST
IN
RESIDENTIAL CONSTRUCTION
PART II
VOLUME ONE

COMMISSION OF INQUIRY INTO
THE QUALITY OF
CONDOMINIUM CONSTRUCTION
IN
BRITISH COLUMBIA

Submitted to
The Lieutenant-Governor in Council
Government of British Columbia
by
Dave Barrett, Commissioner

February 2000

January 31, 2000

The Honourable Moe Sihota
Minister of Social Development and Economic Security
Parliament Buildings
Victoria, BC
V8X 1X4

Dear Minister Sihota,

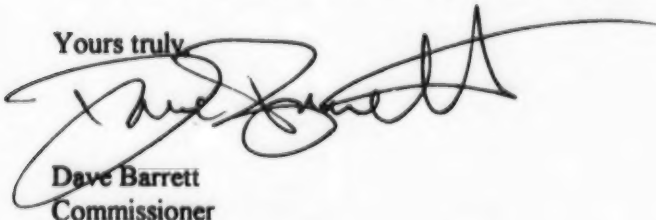
On August 11, 1999, this Commission was re-appointed to inquire into the quality of condominium construction in British Columbia; the financial failure of New Home Warranty of British Columbia Inc.; and the impacts on homeowners, the industry and the economy because of this situation. The Commission was to make recommendations for necessary changes in legislation, regulations, and administrative practices by October 15, 1999.

Unfortunately, the Commission met with resistance from New Home Warranty Board of Directors and former executive staff, rendering it impossible to meet this deadline, or the subsequent deadline of January 15, 2000.

Despite this delay, much of the Commission's work is completed, particularly as it relates to homeowners and the urgent need for financial support to meet the costs associated with this unfortunate disaster. The scope and magnitude of the problem, and the need to address the plight of these unfortunate victims immediately, makes necessary the submission of the Commission's work in two volumes. Therefore, I submit to you, as Volume I, the Commission's findings pertaining to financial compensation.

I anticipate scheduling further hearings to complete the investigation of the remaining matters outstanding in my terms of reference. I will submit Volume II, including all other matters not addressed in Volume I, by March 10, 2000.

Yours truly,

A handwritten signature in black ink, appearing to read "Dave Barrett", with a large, sweeping flourish extending from the end of the signature.

Dave Barrett
Commissioner

**The Renewal of Trust in Residential Construction
Part II : Volume I**

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The Renewal of Trust in Residential Construction Part II: Volume I

A Further Inquiry into the Quality of Condominium Construction in British Columbia

Dave Barrett: Commissioner

This report is being submitted as Volume I, of two, and deals only with the need to provide compensation to homeowners facing repairs as a result of premature building envelope failure. It is being submitted in advance of the Commission's other work because the impact of this crisis is severe and pervasive, resulting in conditions tantamount to a natural disaster.

On August 11, 1999, the Commission of Inquiry into the Quality of Condominium Construction in the province of British Columbia was re-convened. Dave Barrett, former premier of the province, who conducted an inquiry into leaky condos in April 1998, was asked to conduct this inquiry. It was precipitated by the failure of New Home Warranty of British Columbia Inc., (NHW), the province's primary insurer of new residential construction.

The Commission's mandate was to inquire into the adequacy of protection for, and accountability to, homeowners for faulty condominium construction; the causes of the failure of NHW; and the financial, economic, and other costs related to this crisis in residential construction.

The Commission held hearings from September 13, 1999 to January 13, 2000. At the hearings, condominium owners--many who thought they were protected by NHW, and now in the early stages of the repair process, undergoing repairs, or facing bankruptcy and/or foreclosure--voiced their concerns. A broad cross-section of participants in the residential construction industry, as well as federal and provincial agencies and program representatives, also made presentations and answered the Commission's questions.

TERMS OF REFERENCE

1. To further inquire into the quality of condominium construction in British Columbia, in particular, the adequacy of protection for, and accountability to, consumers for faulty condominium construction.

2. To inquire into the impact on homeowners, the housing market, mortgage insurers and the economy of the financial failure of New Home Warranty of British Columbia, Inc., and to inquire into the history of home warranties in BC and the causes of the failure of New Home Warranty of British Columbia, Inc.

3. To inquire into the extent of foreclosures, bankruptcies, and related matters arising from faulty condominium construction.

4. To submit a report by March 10, 2000 to the Lieutenant Governor in Council through the Minister of Social Development and Economic Security, recommending any measures, including but not limited to changes to legislation, regulations or administrative practice, that the Commissioner determines are needed.

The Commission's original reporting date was October 15, 1999. This was subsequently changed to January 15, 2000, and finally to March 10, 2000. The Commission needed to undertake an extensive examination of NHW activities leading up to its failure, and question senior staff and Board members. Much of this work was delayed because of an unwillingness of some parties to participate in the hearing process.

During the Commission's work, a clarification in the terms of reference was sought and granted. This clarification led to the addition of *"and to inquire into the history of home warranties in BC and the causes of the failure of New Home Warranty of British Columbia, Inc."*

Volume II, which will be submitted by March 10, 2000, will cover all the remaining areas of the Commission's work not addressed in this report.

Acknowledgments

The Further Inquiry into the Quality of Condominium Construction in British Columbia required extensive demands on those involved. This important work could not have been completed without the support and assistance of the Commission's advisors and support staff.

The Commission is very appreciative of the extensive support provided by Legal Counsel Peter Leask, Q.C., and Economic and Financial Advisor, Robyn Allan, who so ably assisted the Commission during the first hearings. Both professionals brought to this Commission's work their extensive backgrounds and experience as well as an intense understanding of the issues involved.

Also, I would like to thank Dixie Pidgeon, Tim Woods, Tom Sinclair, Maggie Sanders, Janet Lazarowich, Rita Lalik, Catherine Kottmeier, and John Popkin for their hard work and dedication.

Finally, I would like to express my appreciation to the hundreds of presenters who came forward at the Public Hearings, or who wrote submissions to the Commission. Homeowners who shared their experiences, or industry participants who provided their professional assistance and advice, have been invaluable to the Commission's work. I trust the analysis and recommendations in this report and, subsequently, in Volume II, will provide much needed assistance to homeowners so they can continue to pursue their hopes and dreams, and to the industry, so that it can function in a healthy and prosperous manner.

Additional copies of this report are available from:

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Executive Summary

A further Commission of Inquiry into the quality of condominium construction in British Columbia was appointed by the Minister of Social Development and Economic Security, through an Order in Council, on August 11, 1999 to review the adequacy of protection for, and accountability to, consumers for faulty condominium construction. The Commission was also asked to inquire into the impacts on homeowners, including the extent of foreclosures, bankruptcies, and related matters, and the causes of the failure of New Home Warranty of British Columbia, Inc. The Commission, upon completion of its inquiry, was to recommend any legislative, regulatory, administrative, or other measures needed to ensure consumer protection and accountability for this situation.

The material presented in this report is a result of extensive public hearings, and numerous written submissions, received by the Commission from September 13, 1999 to January 13, 2000. In all, there were 50 sessions of public hearings held in Vancouver, Coquitlam, Richmond, Victoria, and Nanaimo. In total, there were 180 presenters and 336 submissions.

Presentations were made by condominium owners, strata council representatives, concerned individuals, groups involved in various public and private aspects of the industry, and professionals with expertise in related fields. The Commission also reviewed relevant existing legislation, public and private reports, and undertook various background research activities.

The Commission's report has been divided into two volumes. Volume I covers all aspects of consumer compensation, including the magnitude of the problem; review of recommendations contained in the first Barrett Commission report, as they relate to financial support for homeowners; and presents recommendations for a Compensation Plan based on the findings of the recent hearings.

The testimony and submissions presented to the Commission clearly identify that the problem in residential construction is wide ranging and devastating, not just for those with limited means, on pension income or involved in co-operative housing, but also for middle income earners. The Commission has heard compelling testimony from a cross-section of British Columbians which clearly suggests a crisis of unprecedented proportions. This is a disaster--the consequences of which are both devastating and pervasive.

All other issues contained in the Commission's terms of reference will be addressed in Volume II to be submitted to the Minister of Social Development and Economic Security by March 10, 2000.

Premature building envelope failure in British Columbia has become a major economic and social disaster. The lack of quality in design and detail has led to a burden, not only on the unfortunate homeowner, but ultimately, on all BC residents. The cost of repairs is leading to a major reduction in disposable income for a large number of BC residents.

Bankruptcies and foreclosures precipitated by the financial burden have obvious and expensive spill-over costs for all Canadian society.

In its first report, the Barrett Commission estimated that the "direct" cost to repair premature building envelope failure would range between \$600 million and \$1 billion. While there was much debate over the acceptance of this estimate--with many in industry denying it could be that high, and NHW dismissing such a figure in the preparation of its own actuarial analysis--the preliminary data accumulated by the Homeowner Protection Office (HPO) suggests the Barrett Commission report was accurate.

The Commission, in its first report, made recommendations intended to assist homeowners because the estimated financial burden to repair poorly-built, multi-family homes was so onerous. These recommendations included permitting tax-free withdrawals from RRSP's, income tax deductibility of repair costs, waiver and repayment of GST and PST on repairs, reduction of property tax assessments, and the establishment of the provincial Reconstruction Fund.

The Reconstruction Fund, administered through the HPO, was intended to assist the neediest of homeowners and was to be funded from a levy of \$1000 per unit on new residential construction in the coastal region of British Columbia. Bridge financing was to come from the provincial and federal governments.

A number of important Commission recommendations were not implemented. In particular, tax-free withdrawals from RRSP's, income tax deductibility of repair costs, and waiver and repayment of GST, have not been accepted by the federal government. To date, there has been no federal contribution to the provincial Reconstruction Fund.

In addition to the lack of financial support initiatives for homeowners, the failure of NHW has increased the financial burden on a significant number of homeowners. The first Commission report assumed, because of assurances provided by the company, that NHW would be available to homeowners who suffered expensive structural damage to their homes while still under warranty. This proved not to be the case.

On March 30, 1999, NHW made a proposal in bankruptcy. The proposal was accepted at the first meeting of creditors on October 9, 1999. This proposal indicated that homeowners might receive 42 cents on the dollar for their claims against NHW. However, before any payments had been made, the Trustee suspended the plan because filed claims against NHW were approximately triple the actuary's estimate. This increase does not involve the Incurred But Not Reported (IBNR) claims, which remain unknown. Ultimate claims could easily surpass \$150 million. Unfortunately, NHW's reserves were less than \$20 million in February 1998.

NHW's failure and the lack of other financial support programs means there is a far greater pressure on personal resources than initially estimated in the first Barrett Commission report. These resources will be withdrawn from the mainstream economy

and reallocated to repairs. The “indirect” costs of this burden will ultimately be borne by consumers, taxpayers, the residential construction industry, and to a lesser extent, the entire economy.

Indirect costs include a wide range of factors and have an impact greater than just on the lives of condo owners, compromised by poor quality construction. The Commission has categorized these indirect costs as those affecting income, wealth, and health.

i) The Income Effect

- **Consumer Spending:** Excessive repairs result in a decline in disposable income for repair victims leading to foregone opportunity, decline in quality of life, stress and pressure, and a multiplier effect throughout the economy as their spending patterns become dramatically altered.
- **Foreclosures and Bankruptcies:** These are triggered when individuals or families cannot afford the cost of repairs, leading to a greater, negative, economic and social impact, as homes are repossessed and consumer debt is written-off.
- **Shifting of Taxation:** The decline in property values of condos involved in repairs, shifts the municipal property tax burden to other property owners, reducing their disposable income.

ii) The Wealth Effect

- **Housing Industry Performance and Economic Growth:** A decline in property values for condo owners involved in repairs affects the value of all condo housing stock and dampens the overall health and pace of the residential housing market.

iii) The Health Effect

- **Health and Public Safety:** Emotional, psychological and physical problems related to stress, mould, and indoor air quality for homeowners and remedial workers, increases health care costs and Workers’ Compensation premiums.

If no immediate and meaningful steps are taken to provide compensation to homeowners affected by this disaster, indirect costs associated with this problem could be double the direct cost estimate.

Recommendation #1: The provincial government, with cost sharing provided by the federal government and BC residential building industry, take immediate steps to create a Compensation Plan through the HPO. This Compensation Plan is to provide financial support to residential homeowners who have been financially devastated as a result of premature building envelope failures.

Eligibility

The following should be eligible for the Compensation Plan:

- a) homeowners of one residence, regardless whether they dwell in the residence or rent it out;
- b) qualified building envelope repairs, including repairs already undertaken or in the process of being undertaken, on buildings constructed in 1983 or later;
- c) approved repairs by Strata Council, or co-op; and
- d) homeowners who paid the special assessment (that is, if the homeowner purchased after repairs were complete, they would not qualify for the grant).

Compensation

The Compensation to consist of the following:

- a) actual repair expenditures to a maximum of \$25,000, plus 50% of any further repair expenditures, to a maximum grant of \$35,000;
- b) non-taxable grant (adjusted for tax benefit received, if the homeowner rented out the property and declared the repairs as a deductible expense); and
- c) be net of any financial support program funding received, such as PST rebate, RRAP, etc.

Number of Recipients and Cost

The Commission estimates the following:

- a) up to 50,000 homeowners may be eligible--2,500 who have already received HPO low-interest loans; and
- b) total cost of program: \$900 million over five years.

Administration

The Compensation Plan should be administered as follows:

- a) through HPO;

- b) substitute grants for loans already provided under the Reconstruction Loan Program (with the loan program continuing in the few cases of need if the homeowner has difficulty providing for special levies greater than the maximum provided under the grant program);
- c) HPO to determine qualified repairs and vet each grant application. Special committee of HPO to be established to vet repair strategies and ensure timely and accurate data collected to determine the reason for the failures and the most appropriate and least cost-remedial strategies; and
- d) assignment of all subrogation rights to HPO.

Financing

The financing should be as follows:

- a) shared 33.3% each by the provincial government (\$300 million), federal government (\$300 million) and the BC multi-family residential construction industry (\$300 million); and
- b) the building industry's \$750 per unit levy to be discontinued and replaced by a \$2000 per unit fee on new multi-family construction, or 1% of final selling price of new units, whichever is greater (e.g., a \$500,000 condo would contribute \$5000 to the fund).

The allocation of monies from the provincial, federal governments, and the industry would be reduced proportionately by any recoveries from legal actions against builders, architects, engineers, etc.

Homeowners in Foreclosure or Bankruptcy

Special arrangements should be developed for people who have had to enter into bankruptcy or foreclosure because they could not finance their special assessments related to repairs.

Chapter ONE

DISASTER! THE NEED FOR JUSTICE

I. Introduction

"the leaky condo disaster...is [a] complex crisis, one that will be recorded as the worst economic and sociological catastrophe in Canadian history."

*- Simma Holt, Condo Owner
September 28, 1999*

On August 11, 1999, the Honourable Moe Sihota, Minister of Social Development and Economic Security, announced the reconvening of the Commission of Inquiry into the Quality of Condominium Construction. The Public Hearings have revealed to the Commission a number of important issues, including:

1. The magnitude and severity of the problem created by premature failure of residential building envelopes--as anticipated in the first Commission's report--is confirmed by experience. Costs extend far beyond the cost of repairs. These include the increasing propensity of homeowners to declare bankruptcy and insolvency, suffer emotional stress, and experience health problems.

A review of actions taken on the recommendations contained in the first Commission report (June 1998), as they pertain to financial support for victims, reveals that BC homeowners have been woefully neglected. Apart from the provincial Reconstruction Fund and the provincial sales tax (PST) rebate for some strata councils, homeowners facing repairs have essentially been left to their own resources. Appendix I of this report reviews and analyzes the financial support recommendations arising from the first Commission's report.

2. When the first Commission report was written it was believed that a responsible builder-owned warranty company was in place. The Commission had concerns regarding the conflict of interest inherent in the Canadian Home Builders Association of British Columbia's (CHBA-BC) sole ownership of New Home Warranty of British Columbia, Inc. (NHW), its claims-processing practices, and underwriting criteria. However, our concerns were met with assurances from the warranty company and the industry, that it was prudently managed, had adequate reserves and would continue to play a major role protecting homeowners in BC.

When NHW filed a letter of intention to make a proposal under the Bankruptcy and Insolvency Act on March 30, 1999, the company had 84,307 homes at risk, most of them in multi-family buildings.

NHW has now disappeared and homeowners, who thought they were protected, are facing costly and ineffective litigation as the only option for redressing their valid claims. The financial implications of NHW's failure, based on earlier Barrett Commission estimates, appear to be catastrophic for the homeowner--NHW's failure leaves many homeowners in a much worse financial situation than previously anticipated. The failure of NHW also places a much larger burden on the provincial Homeowner Protection Office's (HPO) Reconstruction Loan Fund. This financial burden was never anticipated in the first Commission's report.

3. The current private sector, mandatory, competitive warranty system proposed in the first Barrett Commission report was adopted and implemented by the provincial government. In light of the failure of NHW, a re-examination of this public policy initiative was necessary.
4. Since the first Commission's report, there have been growing concerns regarding the quality of remediation efforts, particularly as they pertain to face-seal construction. Some homeowners report that they have been assessed for second- and third-time repairs. An examination of building science issues with respect to repairs, as well as a review of the proposed repair warranty system and regulation by HPO of repair contractors, was necessary in light of NHW's failure.
5. An extensive re-examination of the BC Building Code, its process of development, interpretation, and enforcement became necessary during this set of hearings, primarily because of widespread confusion within industry and among consumers.
6. Potential health risks to homeowners and on-site remedial workers might exist because of mould related to rot. These concerns were brought forward during the hearings by health practitioners, as well as by workers and homeowners. Illness, symptoms, and remedial action to mitigate the health risk need to be addressed.

The purpose of this report is to address the urgent financial needs facing victims of the leaky condo disaster.

II. Current Situation

During public hearings, presenter after presenter explained how they had been led to believe the private sector system of warranty coverage would protect their homes, only to discover that it had failed them. As well, the NHW proposal approved by creditors on October 8, 1999, wherein creditors had expected 42 cents on the dollar for their claims against NHW, was suspended, and the Commission learned how the bankruptcy and insolvency process had also failed claimants. The impact of this issue is examined in Chapter TWO.

Not only have creditors been abandoned by NHW, the proposal put forward by its Board of Directors has also let them down. At the writing of this report, it was unclear when creditors could expect to receive a portion, if any, of the claims approved by NHW prior to its bankruptcy.

The real tragedy inherent in the failure of the quality of multi-family, residential construction relates to the large number of families and individuals whose lives have been severely impacted because the homes they purchased have not performed adequately. This is a human tragedy--a silent and prolonged disaster.

The testimony and submissions presented to the Commission clearly identify the problem as wide-ranging and devastating, not just for those with limited means, on pension income or involved in co-operative housing, but also for middle income earners. The Commission has heard compelling testimony from a cross-section of British Columbians which clearly suggest a crisis of unprecedented proportions. The consequences of this disaster are devastating and pervasive.

We have heard from young couples who set out to establish a home for a future family, only to face financial ruin.

We've had to live with a nightmare of finding ourselves living in a building ridden with mould and rot, trying to find the funds to pay for it, and raising a baby within scaffolding and tarps. I hope that the Commission this year will help to put forth recommendations that are implemented. I hope you will work hard to do this, because you do not know what this has done to our family.

But if you can, for a moment, I'd like you to imagine. Imagine finding out that you're pregnant one week, and that you're being assessed \$15,000 for your leaky condo the next. Imagine sitting beside your premature baby's incubator six months later, watching him fighting to breathe, and thinking that things couldn't get much worse. Imagine then going home to find your building has complete envelope failure, and your individual special assessment is now up to \$40,000. Imagine, after weeks, finally bringing your now five-pound baby home, only to find that his crib and blankets

have been soaked with water leaking through the ceiling. Imagine living with dusty, noisy construction for more than a year, and wondering how that has affected your baby, who's constantly woken by jackhammers and drills that make his crib shake. Imagine having to call the emergency doctor to your house, in the middle of the night, for your sick baby, and him not being able to find your building because he thought nobody could possibly be living in such a war zone.

*- Stephanie Henders, Condo Owner
November 30, 1999*

For many, it's not only the spectre of financial ruin and health concerns that create anxiety, it's the sense of betrayal when the condo owner has reason to believe that the developer, real estate agent, or former homeowner knew of the construction problems and leaks, and failed to disclose such information.

After we had bought, we found documents that proved both the developer and the real estate agent, who was also my agent by way of dual-agency agreement, knew there was a leak in the building several months before we bought. The building continued to leak and has only recently been fixed, costing me and my family nearly \$20,000 in assessments.

We had to borrow money to pay for the assessment, while the value of our property dropped from \$164,000 to \$118,000....In order to pay for the assessment, I've had to work six days a week, which means no holidays. When the walls were pulled off, we found out that mould was released into the air, and on that exact day, our then seven-month-old son developed respiratory problems that we blame on the mould.

*- Gary Fee, Condo Owner
November 15, 1999*

Elderly women, managing to avoid debt during the Great Depression, emphasizing that they raised their children to be honest and hard working, now find themselves humiliated because they have to borrow for repairs on a home in which they thought they could retire with dignity. Too many face foreclosure, bankruptcy, and a future on social assistance.

As a child we had the old coal-oil lamps—no electricity. My father studied under these lamps improving his education. How my parents ever clothed and fed our large happy family is a miracle.

When I married during the depression years we had progressed to a pump in the kitchen and electricity. Often the pump seized, so we packed buckets and buckets of water to heat on the coal range for household washing and bathing.

During W.W.II it was impossible to buy an electric washing machine. In these former days there were no "pampers" for babies, only flannel diapers to be washed and re-used.

As our children grew, we did our best to clothe, educate, and teach them honesty and morals and manners. We tried to save a few dollars for our old age. No welfare in those days!

I could no longer keep up the small home and large yard so we sold and bought into a brand new "Condo" thinking we could manage, but would have enough saved in case of illness.

Well, what a shock to have discovered the condo was falling down around us! Our little savings were used to repair a new building because of poor workmanship!

*- S. Main
September 30, 1999*

The personal and financial stress as a result of the remediation process is severe and debilitating. It begins with the identification of construction problems and a propensity among some owners to enter a stage of denial, giving way to despair.

Since I addressed you in May 1998, apprising you of my building's estimated \$2-\$3 million repair bill, which is now a \$4.3 million reality, we're halfway through an 11-month restoration. What has changed since your first inquiry, besides me being \$50,000 poorer? I'm still getting flack for bringing my building out of the closet. Most other buildings have the same keep-it-secret mentality. They think that by keeping it quiet, they will save personal embarrassment, and somehow preserve their home property investment value. They're all scared. But being quiet only protects the guilty, and perpetuates the problem.

Every day, there are more homeowners receiving the unwelcome news that their building is leaking. More are facing serious problems that they're having extreme difficulty handling. I've heard stories of contemplated suicide, marital breakdowns, people having to leave their homes for cheaper or shared accommodation, so they can rent the home to help pay for the overwhelming repair cost, and some being forced...into bankruptcy....Nobody, nobody escapes the stress.

Suicides and bankruptcy are not reasonable, viable options. I'll go one step further. Declare it the disaster that it is, and make it outright grants to all affected homeowners for leak repairs.

*- John Murphy, Condo Owner
October 19, 1999*

The stress mounts as it's carried into the debate surrounding appropriate repair methods. Expertise and advice is sought from people and companies whose past work is now in need of repair. Neighbours find themselves at odds over remedial solutions and tension mounts while damage and rot continue.

We are beginning to feel a bit like shark-bait. We have been wounded and victimized by the residential construction industry, and we have grave concerns that we have been or are about to be victimized by the restoration industry. There has been a sudden emergence of building envelope specialists and restoration experts, almost as if there is a sense of blood in the water.

*- Jeff Kay, Condo Owner
September 23, 1999*

More than one strata council representative has told the Commission that the worst moments come when it is necessary to take foreclosure steps against a neighbour, unable or unwilling to contribute to costly repairs.

Within our unit there are foreclosures. Here we are neighbours, now, having to foreclose on our neighbours and friends. And if you've never been in that kind of a situation, I can tell you, it's not one that you can look forward to. We have to pick up the cost of the repairs until the foreclosure and court order sale are complete. And that is another stigma on all leaky condos.

*- Tom Krall, Condo Owner
October 18, 1999*

Once repairs are agreed to, stress is compounded by the dirt, darkness, and noise homeowners must endure while restoration is conducted under tarpaulins and scaffolding. Mould and mildew pose health risks--increased for residents and workers--once repairs begin.

How are they [owners] coping? What is the human cost? Depending on an individual's situation, some have taken living under shrouding, scaffolding, amid dust, noise, and disruptions, in their stride; others have not. Some have moved out temporarily. Those who stayed who are elderly, frail, and ill suffered while workmen tore down the stucco coverings of the walls outside their suites, removed and replaced windows, covered them for months with boarding and tarpaulins, with the result that individuals lived in semi-darkness, dust, noise, chemical smells, and restricted living space, for from two to five months. A number of our elderly owners suffer from terminal illnesses, heart disease, dementia, and arthritis, which were all adversely affected by the additional stress of a radical change in lifestyle.

When people in third-world countries live in these conditions, we call that a disaster. When, as a result of war, flood, or earthquake, Canada sends aid to countries where survivors live in damaged buildings, we applaud our government. Here in our own backyard, in British Columbia, when Canadian citizens, through no fault of their own, must live in damaged buildings, and pay for the repairs to those buildings, this, too, is a disaster which has to be acknowledged.

*- Jean Bateman, Condo Owner
October 19, 1999*

The Commission has also heard from strata councils that have nearly completed renovations. The hope that the worst is behind them is countered by the absence of any meaningful warranty covering these renovations. The marketplace echoes these concerns as strata councils report that little or no resale market exists for units, even after the tarpaulins and scaffolding have been removed.

We have just passed a special resolution directing the strata corporation to assess the amount of \$430,675 to fund the remedial work on our leaky condos. This, after months of investigating, negotiating, restarting after the Home Warranty fiasco, and spending money on lawyers, engineers, consultants, etc., we are proceeding, as the law requires, to fix the mess. This does not mean, however, that every owner of our 36 units is not seething in anger and deep frustration.

Because of this disaster, we have had four owner bankruptcies to date, with the expectation that this is the tip of the iceberg. Although we are proceeding with applications for second and third mortgages, most of us are in no position, financially, to take this hit.

It isn't just the additional mortgage. We cannot sell our homes. For those of us with substantial equity in our homes, this asset has disappeared. Although desperate owners in our building have their homes listed for sale, the reality is that a unit purchased four years ago for \$160,000 will not bring \$95,000 today. On top of that, we have to add an additional \$15,000 mortgage for remedial work. The work, the worry, the inconvenience of living for many months in a construction site with the result, ultimately, of a depleted asset, and these owners are the lucky ones. It's too late now to save some: they have already drowned in their leaky condos.

*- Randy Young, Condo Owner
September 30, 1999*

Clearly, the crisis in residential, multi-family construction is a disaster, albeit a slow and insidious one.

I come before you as a victim of a flood that's destroying my home, one drop of water at a time.

*- Laura Muise, Condo Owner
October 19, 1999*

The outcry of homeowners is surprisingly muted and polite, given the financial and psychological burden thousands of them face. The Commission heard numerous accounts of people who were ashamed, and hence afraid to speak out, intimidated by the developer, strata management company, and other strata owners who did not want their building--and therefore, their property values--to be affected by the leaky condo stigma.

About three months ago, the vice-chair of the council...informed me that there was an owner...who was starving. The owner had chosen not to make an application to the Homeowner Protection Office for funding. She felt ashamed to ask.

*- John Williamson, Strata Council Chair
September 28, 1999*

The legal system, as well, has let down consumers since the cost of pursuing legal redress is too great and the chance of collecting too small. This is because the problem includes numerous defendants--developers, contractors, architects, engineers, municipalities, and NHW--and fraud or negligence must be proven. Developers have been able to make use of corporate structures which protect them from judgments. NHW took on the responsibility for repairs after the first-year workmanship and materials coverage expired, attempting to insulate their registered builders from legal suits.

I investigated the possibility of litigation, and I spoke to one of the better lawyers in town about it, who specializes in this. And he says, "First of all, it's hugely expensive. Secondly, even if you win, how do you collect?" He says, "We're filing one of these things a day, and we're saying the same thing to these people that are involved." So litigation is not really available for the average person.

*- Peter Langan, Condo Owner
October 5, 1999*

In addition, the impact of this disaster, in the past five years, has seeped into the homes and lives of many BC residents--not just leaky condo owners.

The leaky-condo syndrome represents a significant amount of money, with an economic impact on the whole community. There is a spin-off from the people affected. What people do not do with their money in fact, in other

areas...recreation, shopping, travel...affects the economy. Fewer dollars means limited spending.

*- Jean Bateman, Condo Owner
October 19, 1999*

What those people in government office need to be aware of is just how tragic this situation is. This isn't just talking about rotten buildings. We're going to be looking at health care costs in the future. Tremendous health care costs. The next people needing money will be the psychiatrists and psychologists because people will be lining up for help.

*- John Williamson, Condo Owner and Registered Psychiatric Nurse
November 30 1999*

Chapter TWO

THE MAGNITUDE OF THE PROBLEM

I. Background

Premature building envelope failure in British Columbia has become a major economic and social disaster. The lack of quality in design and detail has led to a burden which must be borne, not only by the unfortunate homeowner, but ultimately, by all BC residents. This disaster is not a result of our climate or undiscovered building science, as Adaïre Chown, Senior Technical Advisor, National Research Council of Canada stated during her testimony before the Commission.

Mr. Leask: Do you believe that construction in BC was permitting much greater ingress of precipitation from sometime in the mid-'80s till now, compared with buildings prior to that?

Ms. Chown: That appears to be the case.

Q: And would you comment on whether that's a design problem or a construction problem or both, in your view?

A: In my view it's both.

Q: The design problems being failure to design for our climate, to use a summary; is that right?

A: I don't believe that climate is a causal factor here. I believe that the building envelopes, as designed, would have failed almost regardless of where the buildings were built. We are now seeing exactly the same kinds of failures, with the same kinds of construction in Calgary, which as you'll appreciate, has a much drier climate. We believe that the climate in the BC coastal areas is an accelerating factor, but not a causal factor.

The cost of repairs is leading to a major reduction in disposable income for a large number of BC residents. Bankruptcies and foreclosures, precipitated by the financial burden, have obvious and expensive spill over costs for all Canadian society.

In its first report, the Barrett Commission estimated that the "direct" cost to repair premature building envelope failure would range between \$600 million and \$1 billion. While there was much debate over the acceptance of this estimate (with many in industry denying it could be that high), and NHW dismissing such a figure in the preparation of its own actuarial analysis, the preliminary data accumulated by the HPO suggests the Barrett Commission report was accurate. Given existing trends, the Commission believes that repair expenditures will be closer to \$1 billion.

As of January 14, 2000, the HPO had lent \$55.8 million to 2,379 families in 254 buildings. The total cost for all repairs on those buildings is \$422 million. This represents 42%-70%

of the Barrett Commission's estimated cost of the problem. The total number of units involved in these repairs is 20,250, or 40% of the estimated 50,000 units expected to eventually need repairs.

In its first report, the Commission made recommendations to assist homeowners, since the estimated financial burden to repair poorly-built, multi-family homes was so onerous. These recommendations included permitting tax-free withdrawals from RRSP's, income tax deductibility of repair costs, waiver and repayment of GST and PST on repairs, reduction of property tax assessments, and the establishment of the provincial Reconstruction Fund.

The Reconstruction Fund, administered through the HPO, was intended to assist the neediest of homeowners and was to be funded from a levy of \$1000 per unit on new residential construction in the coastal region of British Columbia. Bridge financing was to come from the provincial and federal governments.

Not all of the Commission's recommendations were accepted. In particular, tax-free withdrawals from RRSP's, income tax deductibility of repair costs, and waiver and repayment of GST have not been accepted by the federal government. There has also been no federal contribution to the Reconstruction Fund.

The GST [on repairs] amounts to a tax on misery. The federal government should not make a windfall profit on the backs of the unfortunate. You should be looking at forgivable loans or grants to cover repairs for those without reasonable, viable options. Suicides and bankruptcies are not reasonable, viable options

*- John Murphy, Condo Owner
October 19, 1999*

In addition to the lack of financial support, the failure of NHW has increased the burden on a significant number of homeowners. The first Commission report assumed NHW would be available to homeowners who suffered expensive structural damage to their homes while still under warranty. Without knowing the state of NHW's financial or reserve positions (because it was an unregulated, non-profit company, whose financial information was private), the Commission had relied on testimony given by the CEO, Mr. David Verge, that the resources available to homeowners through NHW would be substantial. During questioning at the hearings May 8, 1998, Mr. Verge confirmed that the company had adequate reserves, determined by actuarial analysis.

Ms. Allan: Well, my concern is that part of what we've been hearing is that one of the reasons why there are fewer claims settled through New Home Warranty is that the consumer wasn't fully aware of what they purchased. What's happening in this process is the consumer is becoming very aware of what they purchased, and that knowledge could, in fact, change your claims experience, and I'm wondering if you are going to be

solvent in that event.

Mr. Verge: Oh, I would suggest so. I don't suspect for a moment that the severity of our loss experiences in the future is going to be much different than what it is now.

Q: But you do have reserves, based on actuarial...

A: Yes, we have, we have...

NHW was established in 1976 by the CHBA-BC, its sole shareholder. The Board of Directors of NHW was drawn from the board of CHBA-BC, local building associations, and CHBA-BC member-builders. Since NHW's revenue was not to be disbursed to its sole shareholder, the company was registered as a non-profit company under the Income Tax Act. As a result of its pure warranty product and non-profit status, NHW was not regulated by the Financial Institutions Commission (FICOM). The history of NHW and the causes of its failure will be discussed further in Volume II.

On March 30, 1999, NHW made a proposal in bankruptcy and this was accepted at the first meeting of creditors on October 9, 1999. The proposal indicated that homeowners might receive 42 cents on the dollar for their claims against NHW. Before any payments had been made, however, the Trustee suspended the plan because filed claims against NHW were approximately triple the actuary's estimate. This increase does not involve the Incurred But Not Reported (IBNR) claims which remain unknown. Ultimately, claims could easily surpass \$150 million. Unfortunately, NHW's reserves were less than \$20 million in February 1998.

II. Direct Costs

The financial magnitude of the problem, initially estimated by the first Barrett Commission to range between \$600 million and \$1 billion, appears to be correct. The accommodation of this cost was assumed in the first Commission report as follows:

- i) approximately 40% by the Reconstruction Fund;
- ii) 10% - 20% by NHW; and
- iii) the remaining 40%-50% through various tax waivers and rebates, public sector programs through CMHC, and private homeowner resources.

NHW's failure and the lack of other financial support programs mean there is greater pressure on personal resources than initially estimated in the first Barrett Commission report. These resources will be withdrawn from the mainstream economy and re-allocated to repairs. The spill-over costs of this untenable burden will ultimately be borne by consumers, taxpayers, the residential construction industry and, to a lesser extent, the entire economy.

In terms of economic growth and development, premature building envelope failure represents lost opportunity and wasted resources. The effect of the disaster is no different than a billion-dollar oil spill--completely avoidable, and expensive to clean up. Once a disaster like this occurs, the costs become greater if remediation is not undertaken in a timely and efficient manner.

A significant portion of multi-family, residential living is contaminated. If effective, timely, and socially-responsible repairs are not undertaken, the cost of this problem will escalate quickly.

Another direct cost which raises serious concerns is the cost of repeat remedial action.

We're going through second and third attempts at remediating buildings. This is a building...when it was three years old, they discovered a lot of rot and went in and took all the stucco off, improved details and went back with what could be called a concealed-barrier-type wall assembly, which is slightly better than a face-seal wall assembly. We've been back fixing this building over the last year, so in a five-year period, since the original construction, this building has been fixed twice. And you know, it's an incredible hardship to go through this once, but going through it twice is...brutal. And that's a concern because this is not the only building like that.

*- Dave Ricketts, Engineer
October 7, 1999*

The original Barrett Commission's estimate of the cost of repairs included wood frame, under five-story construction, as well as concrete, high-rise construction. Problems in high-rises were not as readily apparent during the first set of hearings. Based on professional engineering judgment, the Commission felt it prudent to include an estimate for high-rise reconstruction problems. Unfortunately, our prognosis is proving to be correct as testimony given on November 1, 1999, by engineer Pierre Gallant confirms.

Mr. Leask: Several presenters have told us that we shouldn't think the problem is limited to 3 or 4 story stucco buildings, that high-rises are going to have building envelope failures (some already have, obviously) and that there's more to come.

Mr. Gallant: Correct on all of the above. The problems with high-rise construction, when stucco is used, its used in a face seal application. You have stucco on building paper on a gypsum material on steel studs. So the assembly is nearly identical to wood frame construction, except you have steel studs and gypsum sheathing instead of OSB or plywood and wood studs. The gypsum sheathing takes a little bit longer to decay and the steel studs take longer to rust than wood studs take to rot. So the process is slower. But yes, we are rehabilitating high rise buildings. Now, there's a systemic failure of these buildings.

High-rise buildings, while slower to manifest problems, are more expensive to repair and are potentially more dangerous than low-rise buildings, once the problems emerge.

The emergence of high-rise buildings is an issue...and it has become a much more significant issue...and I think it will continue to be over the next five to ten years.

Remediation efforts are quite different...Access is an issue, and you're not just putting scaffolding up two or three floors now; you're going right to the top of some pretty tall buildings and that necessarily drives the cost up.

This building...last November, when we had some high winds, it actually had about seven stories of stucco sucked off the back side....[It] fell to the ground.

*- Dave Ricketts, Engineer
October 7, 1999*

III. Indirect Costs

The first Barrett Commission report focused on quantifying the "direct" costs of the leaky condo crisis--the cost to repair. "Indirect," or spill-over costs, such as personal stress, health risks, declining market values, foreclosures, and bankruptcies were discussed in a more qualitative manner. It was assumed these indirect costs would be mitigated because a timely financial support package, as recommended by the Commission, was expected to limit the severity of indirect costs. By containing indirect costs, the entire economy and society benefits.

Unfortunately, the failure to implement many of the Commission's financial recommendations, means that repairs are being absorbed by individual homeowners who face serious financial challenges because they have access only to minimum support through the PST rebate and provincial Reconstruction Loan financing. Because of this limited support, indirect costs will continue to rise, resulting in significant economic and social consequences. These include indirect costs associated with lower disposable income, declining economic wealth, and deteriorating health as defined below:

The Income Effect

The Commission sees several income effects in the following areas:

- i) **Consumer Spending:** A significant decline in disposable income for homeowners who are able to manage the cost of repairs, will result in a decline in their standard of living and a negative economic impact for local and provincial businesses.

Our complex is located in close proximity to major shopping malls such as Coquitlam Centre, Pinetree Village Mall and Sunwood Square. It is also close to recreational/educational and entertainment facilities such as the Douglas College, Town Centre Stadium and Evergreen Cultural Centre. We are one of five complexes in close proximity and it is estimated that in combination that they introduce \$500,000/month into the local economy. It is reasonable to assume that all of these strata corporation will face similar water ingress issues to our building. In that event, it is quite likely that the local economy will suffer from the immediate loss of disposable income.

*- Princess Gate Strata Corporation
May 21, 1998*

- ii) **Foreclosures and Bankruptcies:** Increased bankruptcies and foreclosures for those individuals unable to cope with the financial burden (many of them seniors), will further increase the cost of this problem to the individual, and society as a whole, adding to the social welfare burden.

I'm a chartered accountant and a trustee in bankruptcy with over 12 years of experience as a trustee....Since I started the practice in '93, people having homes in a foreclosure has grown from about five a year to now well over 60 a year, and I'm finding that almost 30 - 40 percent of the people that I meet have a leaky condo....Often it comes down to...can they pay their assessment? And then if they can't pay the assessment, what are their options?

*- Bruce Chisholm, Trustee in Bankruptcy
October 14, 1999*

- iii) **Shifting of the Tax Burden:** A decline in property values will result in shifting the municipal tax burden to other property owners, thereby reducing disposable income.

The costs of leaky condos are beginning to spill over into the economy. Condo owners, keeping the BC Assessment Authority apprised of their situation, are seeing the impact on their assessed values. As many as 7,300 condo owners have experienced a significant drop in their property assessments this year. However, municipal governments, needing to raise sufficient revenue, will increase the mill rate, shifting the burden of property taxation to other homeowners and businesses.

The Wealth Effect

The Commission is concerned about the impact leaky condos will have on the pace of growth in the residential construction market and the ability of the economy to grow.

Housing Industry Performance and Economic Growth: Decreases in property values will result in reduced economic wealth and lower levels of activity. This will, in turn affect the resale market for all multi-family homes.

Another significant result of this "Leaky Condo" situation is the decided decline in property values. The banks and CMHC are putting their units on the market at "give away" prices. A repaired unit originally worth \$170,000 is being marketed for \$90,000. The glut of "firesale" units has destroyed the value of all units. Banks base their loans on market value, the market value of all our units has plummeted--great at tax time but deadly for resale or loan security.

- Strata Corporation LMS 1092

September 28, 1999

The loss of confidence in the competence of our building trade workers and the many developers involved in the building industry will have far-reaching and long-term impact. There are currently thousands of people employed in the building industry, all of whom have families to support and bills to pay. Fewer sales will translate to loss of earning and purchasing power. The governments of the province of British Columbia and Canada will also lose much needed provincial and federal income tax dollars....There will also be a loss of revenue from a resultant decline in collection of the property purchase tax.

- Princess Gate Strata Corporation

May 21, 1998

The Health Effect

The Commission has heard many presentations concerning the effects of leaky condos on public health:

i) Physical and Emotional Health Costs for Homeowners: An increase in physical and emotional health problems of homeowners place an increasing burden on the health system.

I can't sleep at night owing to the leaky problem--it really affects my health! My husband cannot find a job, so despite my health, I have to work but was recently laid off....It's difficult that we have to pay an

extra \$21,000 we can't even afford with the no-interest loan! We can't even sell the apartment, either as nobody would want to buy it now. It's a disaster that our apartment got leaky problems. New Home Warranty is doing the repair work but stops suddenly as they declare bankruptcy....I can't even sleep at night.

*- Sui Wah Law, Winnie, Condo Owner
September 22, 1999*

ii) Workers: The physical health risk to residents and remedial workers affects the cost of health care and Workers' Compensation claims.

I work as a restoration carpenter, I'm here as a parent, friend, and relative of a number of leaky condo casualties. The indoor air quality in leaky condos is the subject I want to address (herein referred to as the hidden cost of leaky condos). There is epidemiological evidence to show that building moisture, mould, and fungal growth have a causal connection to a number of health problems....What about the residents who live in these buildings?

*- Ken Anderson, Restoration Carpenter
September 28, 1999*

From an economic standpoint, financial support is what people need immediately if we are to avoid the economic and social costs that will continue to mount, as homeowners are left to fend for themselves. The Commission, during the most recent hearings, witnessed an increase in indirect costs because of the pressures and strains inherent in this disaster. These costs were not as apparent during the first round of hearings because many strata councils had not yet embarked on the horrific challenges inherent in the repair process.

We have 71 families in our building affected by this crisis. The whole process to date, from hiring an engineer to awarding the reconstruction contract has taken us 17 months. Seventeen months of stress and worry that our owners have endured with many more months to follow behind tarps, dealing with noise, lack of privacy and more stress.

During those seventeen months, at least five families have lost their homes in our building through bankruptcy. Several more are waiting for the last straw, a further assessment. Also, a number of owners have moved and rented their suites, likely to take advantage of the existing federal tax laws allowing non-resident owners to deduct their repair costs from their taxes. This has left a strain, and much more work, for the volunteer Strata Council.

*- Claudette Friesen, Condo Owner
September 28, 1999*

Although the indirect economic and social costs provide adequate proof of the need for compensation--and the wisdom inherent in it from an "enlightened self-interest" point of view--the real issue is not whether the costs of this problem spill over into the lives of non-condo owners. It is the undeniable fact that these homeowners did nothing to bring this hardship upon themselves. Justice can be accomplished only through compensation.

IV. Estimated Total Cost

Having defined direct (repair costs) and indirect costs (income, wealth, and health) associated with this disaster, an estimate of their magnitude is provided below.

A. Direct Costs

The Homeowner Protection Office (HPO) was established to regulate the residential construction industry; assist in the efficient and effective transfer of knowledge within the industry; and provide financial support to homeowners as a lender of last resort, through the provincial Reconstruction Loan Fund.

As of January 14, 2000, 2,379 homeowners have been assisted by the provincial Reconstruction Loan Program. Eligibility for the program requires that homeowners:

1. own a leaky condominium or home where the building envelope deteriorated sooner than expected due to defective design or construction;
2. do not have savings or investments that could be used to pay for repairs (pension assets; RRSP assets, and the first \$10,000 in liquid assets are exempt); and
3. do not have enough equity in their home to qualify for a conventional loan or they cannot afford the monthly payment on a conventional loan.

Loan amounts are based on the cost to repair the building envelope plus related legal costs. Participating lending institutions provide the principal for the loans. Homeowners make monthly, principal-only payments to the lending institutions at an affordable level set by the HPO. The HPO pays the interest portion of the loan directly to the lending institutions on behalf of the homeowners.

HPO reports that, in most cases, no more than ten percent of the homeowners in a building qualify for a no-interest repair loan. However, in some buildings the number of homeowners who qualify could be as high as fifty percent.

As of January 14, 2000, the HPO had received 2,401 loan applications (excluding co-op applications) and had approved 1,806 no-interest loans in 244 buildings, totaling \$34.1 million. About 296 applications did not meet the eligibility criteria, or were withdrawn, with 299 applications currently being processed. The average loan amount was \$19,000.

Co-operative housing projects are also eligible to apply for financial assistance under the provincial Reconstruction Loan Program. Due to the ownership structure of co-operatives (no separate legal title to the individual units) the no-interest loans are provided directly to the co-operative. With the provincial Reconstruction Fund Loan Program expanded in November 1999 to include non-profit housing co-operatives, ten co-operatives have received loan approvals, representing 573 homes, for a total loan amount of nearly \$22 million--an average of \$2.2 million per co-operative. A further 10 applications, representing 1,046, units are before the HPO.

Table 1.

Homeowner's Reconstruction Loan Program

Summary **January 14, 2000**

	<u>Number</u>	<u>Amount</u>	<u>Average</u>
No-interest loans through first mortgage lender	1,476	\$27,662,108	\$18,741
No-interest loans through HPO	98	\$1,716,354	\$17,514
Deferred Payment Loans through HPO	232	\$4,677,551	\$20,162
Co-operative Housing Loan Program	<u>573</u>	<u>\$21,799,900</u>	<u>\$38,045</u>
Total	<u>2,379</u>	<u>\$55,855,914</u>	<u>\$23,479</u>

Source: HPO

The lower mainland municipalities of Coquitlam, Surrey, Vancouver, and Abbotsford represent, respectively, the larger sources of loan applications followed by Victoria on Vancouver Island. Table 2, below, illustrates the distribution of approved loan applications by geographic region throughout the province.

Table 2.

Loan Applications by Geographic Location
As Of January 14, 2000

<u>Location</u>	<u>Number</u>	<u>Percent</u>
Coquitlam	425	17.7
Surrey	353	14.7
Vancouver	342	14.2
Abbotsford	195	8.1
Victoria	174	7.3
Port Coquitlam	167	7.0
New Westminster	125	5.2
Richmond	124	5.2
Delta	75	3.1
Nanaimo	66	2.8
North Vancouver	62	2.6
Langley	62	2.6
Pitt Meadows	50	2.1
Burnaby	37	1.5
Nelson	29	1.2
Others	<u>115</u>	<u>4.8</u>
Total	2,401	100.1

Source: HPO

Errors due to rounding, excludes the loans to Co-operative Housing.

As of January 14, 2000, the total loan amount, including all loans under both components of the provincial Reconstruction Loan Program, was \$55.8 million.¹ The total corresponding value of repairs for all homeowners in the 244 buildings was \$422 million. Although there are some buildings that have undergone repairs without any residents requiring HPO assistance, this figure is a realistic approximation concerning the magnitude of the current direct costs related to building envelope failure. The total direct repair costs will likely approach the upper bound of the estimated of \$600 million to \$1 billion, over the next five years.

B. Indirect Costs

Indirect costs are more difficult to quantify and estimate than direct costs and include a far wider scope impacting income, wealth and health. These costs are not as identifiable as direct costs and have less reliable sources in assessing their magnitude. Indirect costs

¹ All co-op units were developed under the federal co-operative housing program whereby CMHC reviewed and approved plans and specifications and inspected buildings during the course of construction. The average loan amount is double the average homeowner loan because these buildings are in much worse condition. The direct benefit to the federal government (CMHC) through co-op loans, is \$25 million in saved interest costs (over 11 years).

consist of the Income Effect (consumer spending, foreclosures and bankruptcies, and shifting of the tax burden), the Wealth Effect (housing industry performance and economic growth), and the Health Effect (physical and emotional health costs related to mould and stress).

The Income Effect:

The Commission is cognizant of the fact that incomes, in general, are adversely affected by this disaster.

i) Consumer Spending: About 50,000 families in BC will experience a special levy related to building envelope failure by the time this disaster is rectified. Arguably, on purely economic grounds, the spending is not "lost" because labour and materials, consulting services, and all the other items related to repairs will be purchased with this money, and the people providing remedial services will, in turn, spend and save.

However, there is a substantial difference between spending on wants (discretionary spending) and spending on needs (non-discretionary spending). There is a significant difference between spending \$20,000 for a product you already paid for once, and having discretion over where that same \$20,000 is spent or saved.

Repair costs also distort market preferences. They lead to a decline in consumption of a broad range of goods and services (restaurant meals, holidays, children's clothing, etc.), reducing local economic activity while, at the same time, abnormally inflating the demand for restoration activity, potentially bidding up the price of this service.

ii) Foreclosures and Bankruptcies: Foreclosures and bankruptcies are a major indirect cost created by the condo crisis. Of interest to note before providing an estimate of the incidence of foreclosures and bankruptcies, is the role the provincial Reconstruction Loan Program has played to date, as lender of last resort, in mitigating the occurrence of foreclosures and bankruptcies.

Mr. Shayne Ramsay, CEO of the HPO, confirmed in testimony on September 17, 1999, that the collapse of NHW will intensify the pressure on the Reconstruction Program by pulling another group of people into the problem of financing repair costs.

Ironically, the provincial program has bailed out the banks, credit unions, and CMHC. Because the loan fund represents the "last resort" for applicants, nearly all would have defaulted on their existing home mortgage if the fund were not available.

Mr. Ramsay: *The general criteria is if a homeowner's able to qualify through conventional means, and by "conventional means", typically that's adding or increasing their first mortgage. They would have to meet the bank's TDS and GDS ratios. If the homeowner doesn't--is not able to obtain that kind of financing, then they're eligible for assistance under our program.*

Ms. Allan: *Would it be fair to say that many of the people that come to you may have gone into foreclosure or bankruptcy if you weren't there?*

A: *I think that's a fair statement.*

Q: *So if we're looking at the benefits of the Reconstruction Fund, not only do the homeowners benefit if they're able to qualify, but the banks and CMHC, who would be facing a defaulted loan, are also major beneficiaries of the fund?*

A: *Yes, absolutely.*

Q: *And so it would be fair to suggest--and I think you said the number of applicants that you have approved is--I forgot the number?*

A: *Slightly more than 1,000²*

Q: *That some part of that number would have been in the foreclosure database.*

A: *I think you could assume a very high number, if not all, would have been in a foreclosure situation.*

Q: *And since part of the Commission's work is to look at the impact on the economy and individuals as a result of the lack of quality construction and New Home Warranty's failure, is foreclosures and the impact on the economy, when we are looking at foreclosure information, it would then be fair to take some portion of that number and use that as what could have happened in the economy without some form of financial support for homeowners?*

A: *Yes*

Q: *Okay. What percentage would you think would be a reasonable number of those thousand people?*

A: *...it would be a very high number. Probably safe to say almost all.*

In the absence of the provincial Reconstruction Fund, the number of foreclosures and/or bankruptcies would have been increased by about 2,500 during the past year.

A mortgage foreclosure can arise when a homeowner fails to make mortgage payments or fund special levies assessed by a strata council. Foreclosures initiated by strata councils for assessments place the strata council ahead of any financial institution's mortgage payments.

² As of January 14, 2000, the number is 1,806.

Many units have a CMHC-insured mortgage, resulting in CMHC paying the financial institution the value of the mortgage. CMHC then becomes the owner of the unit. In BC, the mortgagee can both seize and sue the homeowner for the net mortgage default amount.

Recent circumstances surrounding the leaky condo situation have led to a change in consumer behaviour with respect to foreclosures and bankruptcies. Historically, people facing difficulties with their mortgage would go through foreclosure proceedings. Now, the incentive is to first file for bankruptcy, with the foreclosure occurring subsequently. While the bankruptcy proceedings are taking place, the homeowner can position themselves more effectively financially; stay in their homes five to six months, mortgage free; and have all debts erased when the bankruptcy is complete.

This change in consumer behaviour means that bankruptcy statistics and trends should be viewed in advance of foreclosure statistics to get a sense of the magnitude of insolvency. Given that bankruptcy has a greater economic and personal cost than foreclosure, this trend is truly regrettable.

People who face bankruptcy because of leaky condo repairs do not exhibit the typical profile of consumers generally faced with this magnitude of financial restructuring.

Most of these people are...would never have stepped into my office, as a trustee, but for the fact of the leaky condo. Most of them have purchased their home as a first step in a financial plan to eventually get into a single-family home and raise a family....What they're seeking is really some advice as to what to do. There is an awful lot of misinformation, there's a lot of people that really don't know their rights and responsibilities...but they're really threatened. They are usually the first-home buyers, having only put down 5 per cent, often by redeeming their RRSPs...and they don't have many assets.

*- Bruce Chisolm, Trustee in Bankruptcy
October 14, 1999*

In 1998 there were 7,327 consumer bankruptcies in BC; 3,399 in greater Vancouver. In the absence of the provincial Reconstruction Fund, approximately 2,500 more bankruptcies would have occurred. Assuming the average cost of a leaky condo bankruptcy is \$55,000,³ the indirect costs saved because of the

³ The rough rule of thumb is that a bankruptcy "costs" the assessment (assumed to be an average of \$20,000) plus one-half again, as well as the loss to other creditors (assumed to be \$25,000). It is important to note, that consumers filing for bankruptcy because of the leaky condo crisis would not have found themselves in this position under normal circumstances because the unsecured debt they "default" on could more than adequately be handled by their income.

provincial Reconstruction Fund is a staggering \$137.5 million, most of which is a direct benefit to financial institutions and CMHC.

Estimating the full incidence of foreclosure and bankruptcy as a result of the leaky condo crisis is extremely difficult at this stage. The Commission reviewed bankruptcy data over a number of years, by urban centre, without being able to determine an obvious trend which could be linked to this crisis. Foreclosure data was also examined and special analysis was undertaken to determine foreclosures related to leaky condos. Again, the data was inconclusive. A foreclosure related to special assessments, which would be levied in the event of building envelope repair, is identifiable as part of the Condo Act Charges (CAC) on foreclosure documents filed in municipalities. Although CAC foreclosures in 1999 are up from 1998, so are all foreclosures. CMHC declined to disclose data on foreclosures voluntarily.

It is quite possible that the foreclosures and bankruptcies that could eventually occur because of the leaky condo crisis have not begun to appear significantly in the statistical data. Rather, they may be in process and it is too soon to tell what the numbers and costs might be. Since foreclosures and bankruptcies take six to nine months to process, the real incidence of this problem may not be felt until later.

People having homes in a foreclosure has grown from about five a year to now well over 60 a year. [In my practice]...I'm finding in the last two months, that almost 30, 40 per cent of the people that I meet have a leaky condo...

I'm leaving the office at 8:30 at night now. And the reason is the New Home Warranty failure. Up to that point there was some hope, and then, I think, as the public becomes more aware of what this issue is and how big it is, that people are going to lose hope, and that's a terrible thing to lose...

But if September and this month are any indication of what our volume is doing, I'm sure that its just going to be a very big issue for the year 2000.

*- Bruce Chisholm, Trustee in Bankruptcy
October 14, 1999*

The provincial Reconstruction Loan Program assumed other financial support measures would be implemented to assist homeowners in managing the burden of their repairs. Unfortunately, many homeowners face such extreme financial pressures that even a provincial Reconstruction Loan can not save them. This leads to an increase the number of foreclosures and bankruptcies. With the failure of NHW, the pressure is even greater. More and more people will choose to declare bankruptcy and face foreclosure than take on additional debt, even if it is interest free.

This is just not fair. I was prudent in the management of our financial affairs. I never lived beyond my means. I've lived frugally. Through no fault of my own, I'm being forced into bankruptcy. I do not have the means to pay back a loan on any terms. If I can sell, I will have no equity left, leaving me a burden on the welfare system for life.

*- Jeanne Good, Condo Owner
November 8, 1999*

It would not be unreasonable to assume an additional 2,500 bankruptcies and foreclosures could occur during this year if financial support is not forthcoming, adding approximately \$137.5 million to the cost equation.

iii) Shifting the Burden of Property Tax: To the extent that 7,300 homeowners had their property assessments reduced this year to reflect a decline in the value of their homes because of this disaster, municipalities, in order to maintain their revenue base, will raise mill rates, shifting the tax cost onto other property owners. Left unchecked, the decline in assessed value can be expected to be more pronounced in future years, providing a larger burden on homeowners not directly affected by repair levies.

The Wealth Effect

Housing Industry Performance and Economic Activity: The impact of the uncertainty surrounding the leaky condo crisis and the costs of needed repairs can lead to hesitation among potential homebuyers, a stalling in the plans of move-up buyers, and a glut of product on the market. These conditions lead to a decline in property values, and can begin to dampen the entire housing market--both resale and new construction. The Commission, in its first report, recognized the importance of residential construction to BC's economic growth.

Residential construction activity in BC is a key component of economic growth, employment, and income. Construction is BC's second largest industrial activity, in terms of value and employment. Approximately 10.7% of the province's annual output and more than 10% of the province's employment is driven by residential construction.

The impact of the housing market on the pace and magnitude of business cycle activity exists because of the strong relationship between residential construction, job creation, and consumer spending. The number of jobs created by a typical housing start is 2.5, including the effect of on-site employment, off-site employment, and spin-off spending. Simply put, each housing start injects approximately \$100,000 into the economy. For example, housing starts in the early 1990s averaged 38,000 per year.

During the latter part of the decade, they fell to an average of 31,000 per year. This decline has reduced economic growth by more than \$700 million per year. Because of the strong impact on economic growth, maintaining stability in the housing market becomes an important consideration, not only for individual economic wealth, but also for public policy.

*- Barrett Commission Report
June 1998*

Due to a major economic downturn in Asia, a significantly lower level of immigration to Canada, especially British Columbia, and out-migration from BC to other provinces, the BC housing sector has experienced a major decline. Contributing to this decline, particularly in the multi-family residential sector, is the leaky condo disaster.

The decline in general economic activity, coupled with the emerging repair needs of many multi-family housing projects, is creating an economic problem. Unless significant and urgent action is taken to re-inject trust into the marketplace, the costs to society will continue to escalate.

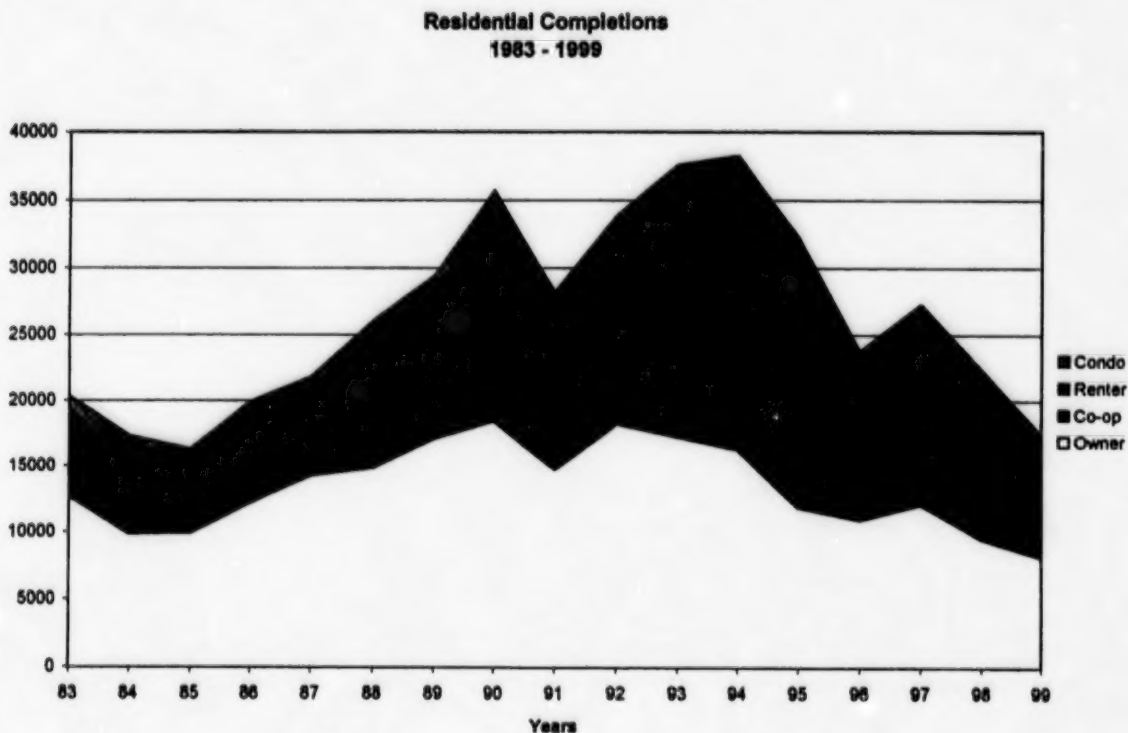
*- Barrett Commission Report
June 1998*

In BC, housing starts have fallen from 43,000 in 1993 to 25,000 in 1998, and 16,309 in 1999. CMHC, in its most recent housing forecast for 2000, is predicting an improved residential construction market because of a modest gain in inter-provincial migration (after seven previous quarters of out-migration) and an increase in general economic activity. Consequentially, provincial housing starts are predicted to increase 10 percent, from 16,309 to 18,000, for the year 2000.

Multiple housing starts in the Vancouver metropolitan area are down 40 percent for 1999 compared to 1998 having fallen from 8,505 to 5,109.

Graph 1, below, illustrates new residential construction activity in BC from 1983 through 1999, in single family, condo, co-op, and rental construction. The market has been in a downturn since 1994. Condo activity has been the hardest hit segment of the residential construction.

Graph 1



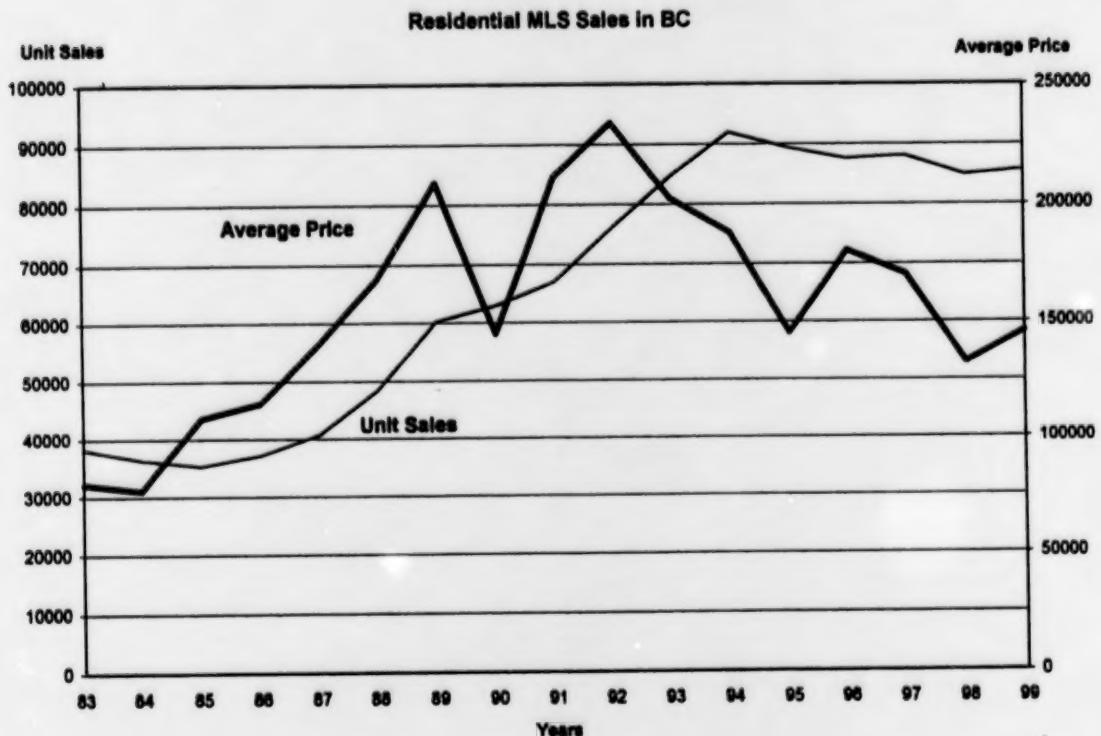
Source: CMHC

Although it is difficult to identify the relative contribution of the crisis to this decline in new construction activity, the crisis has clearly played a role. Assuming the leaky condo problem has contributed 10 percent to the overall decline in starts, the indirect cost to the economy in 1999, in terms of lost economic wealth, is \$300 million.

CMHC's forecast states that current housing starts are below population needs in British Columbia. Uncertainty and lack of trust in the quality of construction for multi-family housing can only heighten this problem. Given the problem in condos (which represent 16 percent of the housing stock), we could run the risk of having two distinct housing markets if support action is not undertaken. These two distinct markets would be condos and other housing.

Graph 2 illustrates the decline in market activity as represented by residential sales and average prices. Residential sales, which include new and existing housing, have fallen to about 53,000 units in 1998, but improved moderately during 1999 to over 58,000 for the first eleven months.⁴ The average selling price has decreased since 1994 from about \$230,000 to \$212,000 in 1998. Recent MLS sales reflect a slight increase in price to \$214,000.

Graph 2

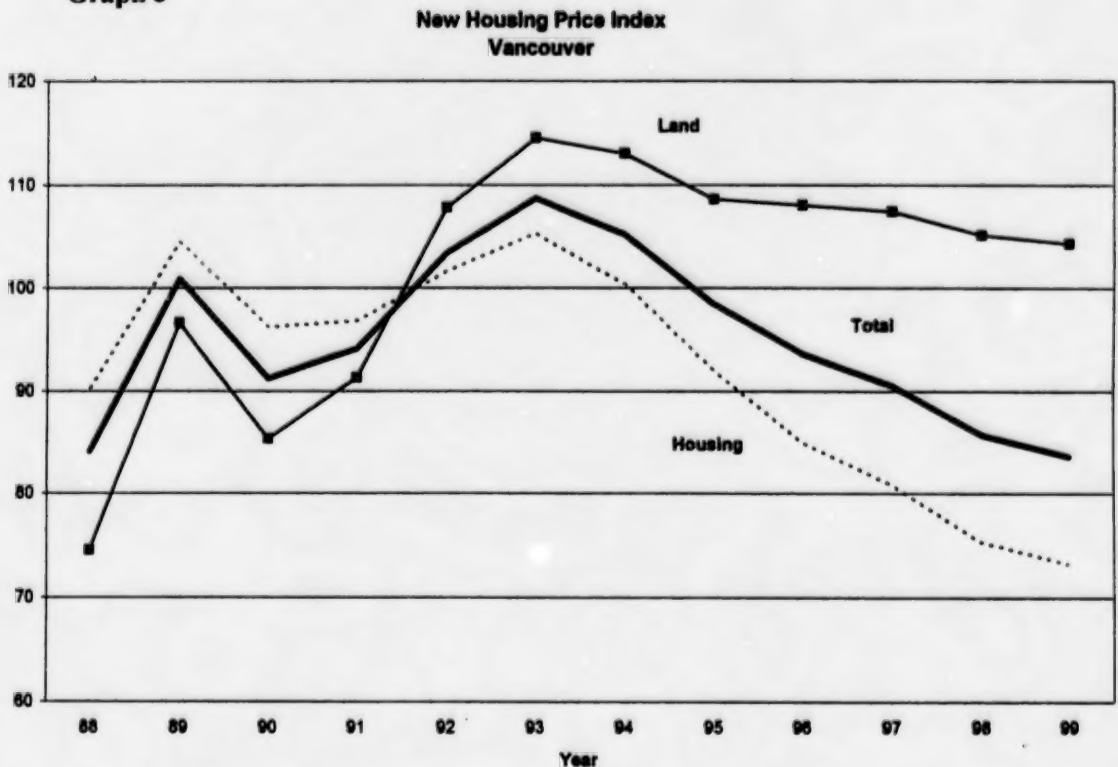


Source: BC Real Estate Association

On the other hand, slower economic growth is continuing to improve housing affordability. Graph 3 illustrates that construction costs and land prices continue to fall in Vancouver.

⁴ This increase reflects activity in single family and townhomes, rather than in condo sales.

Graph 3



Source: CMHC

Single family homes are anticipated to lead the way in housing starts in 2000 while multi-family construction lags. Weak consumer confidence, lack of liquidity because of the inability of homeowners to sell problem units, foreclosures and bankruptcies which distort market value, all lead to a slow-down in the market. Weak consumer confidence, if not addressed, will continue to be a stumbling block for BC's housing market.

The Health Effect

i) Mould: Faced with costly and complicated repair options, most strata councils struggle with remediation choices. Owners of the most leaky condo units must wait for repair work schedules and strategies to be adopted by their neighbours--many of whom may live in perfectly dry and safe units elsewhere in the complex. It is clear that a delay in remediation work increases the opportunities for toxigenic moulds to grow. The Commission has heard frightening stories of personal health consequences from residents whose exposure to these moulds has seriously and permanently impacted their own health or that of their family members.

It is important to note that most people seem quite tolerant of exposure to typical mould growth and can even withstand exposure to higher levels of fungal growth for modest periods of time. However, the evidence presented to the Commission suggests that exposure to some moulds represents a serious risk for all people. It is particularly serious in "at risk" categories, such as the very young, the old, or those with immuno-compromised health status who should avoid exposure to prevalent toxigenic moulds.

...when people start doing the remediation work within their homes, this is where you can potentially release a large amount of fungal spores, which are basically abnormal agents which can interact with your lung tissues and cause an allergic reaction.

*- Dr. Chris Van Netten, Microbiologist
December 7, 1999*

Health issues related to mould and leaky condos are only now coming into focus--too late for some homeowners.

I actually had severe sinus involvement and severe head pain. It feels like you have a boil or an abscess in your head. My nailbeds, in my feet were affected by fungus. I had lesions on my feet, the soles of my feet. I had abscessed gums in my mouth, and in the bone...and upper respiratory infections for two winters, which put me in bed for several weeks, with chest involvement. And that was severe bronchitis, almost pneumonia.

*- Sandra Roth
December 9, 1999*

Health Canada has taken a leadership role in protecting some Canadians from exposure to toxigenic moulds in British Columbia, but the assistance has been limited to some First Nations' reserves on Vancouver Island. It is clear that concern for the health of both residents and workers repairing leaky condos is an urgent and compelling public health issue. It deserves immediate and comprehensive action by Canada's health and safety community.

By providing a compensation package for leaky condo victims, repairs can take place in a timely and effective manner, avoiding the necessity for some people to live in units exposed to mould growth. Volume II will deal more extensively with the need for guidelines and practices for people living in leaky condos, as well as workers who repair them, to mitigate health consequences.

The focus of this Volume is the cost related to inappropriate or ineffective remedial action. Although there are numerous health science questions which need to be addressed before any definitive estimate of the health consequences can be provided, there are some "at risk" individuals whose health may have already been

severely compromised because of air quality and exposure to contaminants in leaky units.

ii) Stress: The Commission heard testimony and received submission which told of sleepless nights, divorces, loss of jobs, and even attempted suicides--all related to the pressure of excessive repair bills. A leaky condo owner is a victim of a system that failed. They experience all the symptoms consistent with the experience of other victims. If financial support is not provided to condo owners, social health and welfare costs will mount.

V. Summary

If no immediate and meaningful steps are taken to provide compensation to homeowners affected by this disaster, indirect costs associated with this problem could be double the direct cost estimate.

Chapter THREE

COMPENSATION

I. Introduction

It is the view of this Commission of Inquiry that the leaky condo situation is a catastrophic disaster, resulting in serious harm to the health, safety, and welfare of thousands and thousands of Canadians.

Accordingly, the Commission strongly recommends that a comprehensive financial support program be provided through the current provincial legislative authority of the Homeowner Protection Act and the Reconstruction Program.

Section 24 of the Homeowner Protection Act states, "*A program is established to be known as the Reconstruction Program for the purpose of providing financial assistance to eligible homeowners for home construction.*"

As detailed below, the financing of the Compensation Plan would be shared one-third among the provincial government, the federal government, and the BC residential construction industry.

II. Compensation Plan

There is an urgent and immediate need to provide emergency financial assistance to all homeowners affected by the disaster in residential housing. The conditions faced by these unfortunate victims include:

- i) inadequate funds to repair their homes;
- ii) financial ruin and possible bankruptcy;
- iii) humiliation, emotional stress and uncertainty; and
- iv) health risks, particularly for senior citizens and young children.

This is a crisis of unprecedented proportion. The consequences are both devastating and pervasive, not only to the individuals affected but, also, as documented above, to society as a whole--British Columbian and Canadian.

The Commission recommends that, under the provincial Reconstruction Program, a Compensation Plan be introduced to provide homeowners, facing repairs, with financial compensation.

Recommendation #1: The provincial government, with cost sharing provided by the federal government and BC residential building industry, take immediate steps to create a Compensation Plan through the HPO. This Compensation Plan is to provide financial support to residential homeowners who have been financially devastated as a result of premature building envelope failures.

It is estimated that up to 50,000 homeowners may qualify for this grant, and the cost would be approximately \$900 million over five years. The grant would replace loans under the Reconstruction Loan Program. The loan program would continue for the few cases where the grant is insufficient to remove a homeowner from the prospect of financial ruin.

The HPO would administer the Compensation Plan and determine qualified repairs associated with each grant request. A small technical committee, consisting of qualified engineers, architects, and technologists would be established to review and approve repair strategies, consistent with the most appropriate and least-cost remedial method.

The Commission recommends the financing of this Compensation Program to be shared 33.3 percent by each of the provincial government, federal government, and the residential building industry of BC. This funding is estimated to be \$900 million over five years.

The building industry's contribution would be derived from the special levy on new multi-family construction. The present \$750 levy would be replaced by a \$2000 per unit fee or 1 percent of the final selling price of new units, whichever is greater. It is anticipated that once the multi-family market recovers units could be constructed at a level closer to 15,000 per year. At this level, about \$35 million would be provided to the Compensation Fund, requiring roughly a ten-year time horizon until the levy was abolished.

An important aspect of the Compensation Plan is that the recipient of the grant would assign all legal claims to the HPO (subrogation rights). This would result in the HPO taking over the plaintiff's position in almost all the litigation arising from leaky condos, regardless of who the defendants are.

It has been suggested to the Commission that some defendants are refusing to settle or mediate on the theory that their "deep pockets" will permit them to win by attrition against the homeowner with limited reserves. The HPO could then attempt to recover costs from defendants by negotiation or mediation, if possible, and by litigation, if necessary. If more was recovered than had been paid out to the claimant by way of the Reconstruction Grant Program, the HPO would return any net recovery to the claimant.

The following summary provides point form details associated with the Compensation Plan.

III. Summary

Goal

The goal of the Compensation Plan is to provide compensation to residential homeowners who have been financially devastated as a result of premature building envelope failures and have been assessed by their strata council, or co-op, for qualified repairs to their building envelope. For other residential grant requests, HPO qualifies the repair.

Eligibility

The following should be eligible for the Compensation Plan:

- a) homeowners of one residence, regardless whether they dwell in the residence or rent it out;
- b) qualified building envelope repairs, including repairs already undertaken or in the process of being undertaken, on buildings constructed in 1983 or later;
- c) approved repairs by Strata Council, or co-op; and
- d) homeowners who paid the special assessment (that is, if the homeowner purchased after repairs were complete, they would not qualify for the grant).

Compensation

The Compensation to consist of the following:

- a) actual repair expenditures to a maximum of \$25,000, plus 50% of any further repair expenditures, to a maximum grant of \$35,000;
- b) non-taxable grant (adjusted for tax benefit received, if the homeowner rented out the property and declared the repairs as a deductible expense); and
- c) be net of any financial support program funding received, such as PST rebate, RRAP, etc.

Number of Recipients and Cost

The Commission estimates the following:

- a) up to 50,000 homeowners may be eligible--2,500 who have already received HPO low-interest loans; and
- b) total cost of program: \$900 million over five years.

Administration

The Compensation Plan should be administered as follows:

- a) through HPO;
- b) substitute grants for loans already provided under the Reconstruction Loan Program (with the loan program continuing in the few cases of need if the homeowner has difficulty providing for special levies greater than the maximum provided under the grant program);
- c) HPO to determine qualified repairs and vet each grant application. Special committee to be established to vet repair strategies and ensure timely and accurate data collected to determine the reason for the failures and the most appropriate and least cost-remedial strategies. This committee should consist of engineers, architects, technologists etc.; and
- d) assignment of all subrogation rights to HPO;

Financing

The financing should be as follows:

- a) shared 33.3% each by the provincial government (\$300 million), federal government (\$300 million) and the BC multi-family residential construction industry (\$300 million); and
- b) the building industry's \$750 per unit levy to be discontinued and replaced by a \$2000 per unit fee on new multi-family construction, or 1% of final selling price of new units, whichever is greater (e.g., a \$500,000 condo would contribute \$5000 to the fund). At the rate of 15,000 units per year, about \$35 million per year would be provided to the fund, requiring approximately a ten year time horizon for the levy.

The allocation of monies from the provincial, federal governments, and the industry would be reduced by recoveries from legal actions against builders, architects, engineers, etc.

Homeowners in Foreclosure or Bankruptcy

Special arrangements should be developed for people who have had to enter into bankruptcy or foreclosure because they could not finance their special assessments related to repairs.

The Commission envisions a program which would allow homeowners, who have been unable to manage the cost of the repairs to their home, and have elected to declare bankruptcy or allow foreclosure proceedings to begin, to qualify for this grant program and have their home returned to them. It is anticipated that, for people not through proceedings, the process would be reversed, and that CMHC and financial institutions

would accommodate the homeowner's situation to ensure their credit rating is re-established.

Homeowners who have completed bankruptcy or foreclosure proceedings, but whose homes have not been sold by CMHC and/or a financial institution, would have the opportunity to reclaim their home.

APPENDIX I

Appendix I.

FINANCIAL SUPPORT RECOMMENDATIONS FROM BARRETT I

I. Review and Analysis

The Commission, in its first report, based its policy recommendations on providing some form of financial assistance to homeowners significantly affected by water damage to their homes, on a number of principles, including:

1. a recognition that home purchasers acted responsibly when making their decisions to buy;
2. a recognition that it is not the role of government to protect private capital. However, when individuals face bankruptcy or foreclosure, the cost to society of allowing individuals to lose their assets is often greater than the cost of providing support and, therefore, protection is desirable from a public policy perspective;
3. government programs which assist homeowners to make repairs in a timely manner support the value of residential property; stabilize the market; and create jobs and business income, allowing for a continuation of economic growth and development, upon which taxes are paid. The absence of program support can trigger a decline in economic growth, thus leading to a multiplier effect. This situation must be avoided through the use of fiscal policy measures, many of which are already in place and require minor modification to be effective;
4. notions of fairness and equity suggest the net financial treatment of the owner/occupier must be the same as the net financial treatment of the owner/landlord;
5. government, or the private sector, should not benefit as a result of hardships faced by homeowners; and
6. policies and programs currently implemented to assist the residential real estate market for consumers, developers, lenders, or others engaged in the industry, should also extend to include the rebuilding of the residential construction industry.

As a result of these principles, a number of financial support recommendations were made in the first Barrett Commission report including #2 v) , #24, #47, #48, #51, #70 - #82. The following discussion addresses each of these recommendations, outlines developments to date, and provides a follow-up comment based on the recommendations provided in this report.

Recommendation #2: That the provincial government introduce, as quickly as possible, legislation to establish the Homeowner Protection Act and create the Homeowner Protection Office to:

v) establish a reconstruction fund as a source of support for residential homeowners hardest hit by problems with construction quality.

Recommendation #70: That a Reconstruction Fund for homeowners be established through the Homeowner Protection Office to provide financial resources to those most adversely affected by problem buildings.

Recommendation #24: That developers and builders pay a special levy of \$1,000 per unit to be built in the coastal climate region of BC. This levy is to help finance the Reconstruction Fund available to homeowners facing repairs and most in need as a result of poor quality construction.

Recommendation #47: It is imperative that the federal government and CMHC provide a significant contribution toward homeowners who have been hurt by this crisis of quality, not only to alleviate the threat of bankruptcy for individual homeowners, but also to protect the solvency of CMHC, and the stability in the residential housing market of British Columbia.

A Reconstruction Loan Fund has been established by the provincial government (explained in detail in Chapter TWO) and is funded through a levy of \$750 per unit on new residential construction in the coastal climate of British Columbia with \$75 million in bridge financing from the provincial government. The federal government offered a \$75 million bridge financing loan for the Reconstruction Fund, but since it carried an interest rate higher than the provincial borrowing rate in capital markets, the province rejected the proposal.

The Commission still feels strongly that the federal government should participate in providing homeowners, hit by this disaster, financial assistance on the basis of social justice, sound economics, and political responsibility.

Recommendation #75: The same rules as apply for use of RRSP funds for the down payment of a home, apply for any homeowners resident in BC, who want to undertake repairs. This would mean that an individual and spouse could withdraw up to \$20,000 each without penalty, to be repaid within 15 years on a schedule of at least 1/15 per year.

Recommendation #76: The rules respecting the use of RRSP be applied retroactively for any taxpayer who has withdrawn RRSP funds to effect repairs under a special assessment. The taxpayer would apply for their income tax rebate in their 1998 tax return, which would be equivalent to the taxes they paid for withdrawals, related to homeowner repairs or renovations in their taxable income.

The response from both the federal government and CMHC on the above recommendation was silence. However, CMHC and Revenue Canada already had in place RRSP self-directed mortgages with CMHC insurance, allowing homeowners to borrow their own RRSP funds for home repairs.

In fact, after the Commission was reconvened in 1999, this matter was brought to the attention of CMHC. Vague responses were initially received about uncertainty as to whether leaky condo repairs would qualify. After considerable research and further inquiries by the Commission to CMHC, it was finally determined that any BC homeowner could borrow funds from their RRSP for purposes of home repairs without affecting their non-taxable status, as long as the mortgage was insured by CMHC.

However, after a number of visits by Commission staff to local chartered banks and credit unions, it was discovered that financial institutions' staff did not know about this option or, if they did, the product (a self-administered RRSP mortgage used for the purpose of home repairs, with CMHC insurance) was being actively discouraged under the claim that the fees and appraisal costs (about \$1,000) rendered this option non-competitive. Obviously, when a homeowner is facing a \$30,000 assessment which must be paid out of after-tax dollars as compared to accessing their pre-tax RRSP funds which they can pay back to themselves at market rates of interest, the cost-benefit is apparent. At no time did the federal government, CMHC, or financial institutions consider it desirable to make this information known or easily accessible.

Because homeowners were unaware of this program, a number exhausted their existing RRSP funds and paid income taxes accordingly, violating the Commission's principle that government should not be seen to benefit from the affects of this tragedy. When Mr. Jim Lynch, CMHC General Manager for BC and the Yukon testified before the Commission on November 3, 1999, the following exchange took place during the question period:

Ms. Allan: But this other product has existed for some time, and certainly within the last year. Was there any reason why CMHC didn't feel that it would be helpful to condominium owners to advertise this product. Because the banks certainly aren't doing it.

Mr. Lynch: No

Q: No regulations, no laws have to change, and we know of many homeowners who have liquidated their RRSPs, paid very high taxes to the federal and provincial government, and now have no retirement savings, and they could have had a self-directed mortgage.

A: Well, the information on the program is available ---

Q: Where?

A: You're suggesting that it should be promoted more. I'll take that advice. The --- I guess the judgment, and it could have been incorrect, that there would not be a large take-up of individuals who are in the circumstance of having large RRSP accounts that in fact would want to see it in a self-directed RRSP. They'd like to see their money doing better work for them in other investment vehicles.

Q: Let's just look at the numbers, okay?, and I can understand if the marketplace take-up was low, but there weren't these kinds of repairs needed before. The environment is different. But let's just take an analysis. If I have a \$20,000 special assessment, and I have to go to my bank and get a personal loan at 9 per cent, and pay for that out of after-tax dollars, that's one thing. That's a certain cost. But most of the people that are looking at liquidating their RRSPs have exhausted those avenues. So we're facing a situation where a consumer may only have an RRSP for \$30,000, and not knowing about this product, liquidated \$20,000, paid a 50 per cent tax rate on it, and now has no opportunity to put that money back into their retirement savings. There's a serious situation of a very different market environment for all these homeowners, and if even 20 per cent of them are faced with this opportunity, wouldn't it be incumbent upon the banks, and in fact CMHC, to help identify this for consumers? Because if you're working with your mortgage-insured consumers on trying to provide the best extension of their loans, and you're looking at market rate, why wouldn't that other opportunity also be provided to them, as a way to avoid expensive borrowings?

A: Well, the product was available, and the product---

Q: Was not advertised.

A: It was not advertised.

It is useful to note that, when severe flooding devastated some regions in southern Manitoba in the Spring of 1997, and severe ice storms impacted residents of eastern Ontario, Quebec, New Brunswick and Nova Scotia in January 1998, Revenue Canada made tax concessions and provided background information on tax matters to assist those victims of the disasters.

In an effort to assist Canadians in areas affected by the ice storm, and in the interest of fairness and flexibility, Revenue Canada is offering relief to those taxpayers who received financial assistance to help them through their period of hardship.¹

When disaster strikes, the federal government provides assistance to the provinces through the Disaster Financial Assistance Arrangements when the cost of dealing with the disaster would otherwise place an undue

¹ Press Release, Revenue Canada, Federal tax relief for 1998 ice storm victims, March 11, 1999.

burden on the provincial economy. In general when victims of a disaster receive payments from the government for personal losses, these payments are not taxable.²

No such information was made available by Revenue Canada to leaky condo owners in British Columbia.

Recommendation #77: Since the treatment of homeowners, who rent their units, is different from homeowners who live in their units, it is imperative that the cost of all qualified repairs be deducted from income. The application of this exemption would be retroactive and, as such, would provide a cost carry-back and carry-forward for homeowners. The application of this recommendation requires federal and provincial government approvals and, as such, is a cost-shared, tax expenditure.

Recommendation #79: For purposes of reconstruction, all GST and PST, payable on qualified repairs and renovations, should be repealed. In this way, the owner/occupier is treated by taxation the same way as the owner/landlord.

Recommendation #80: All GST and PST that has been paid on renovations should be refunded to homeowners.

The federal government has rejected all of the Commission's recommendations on providing tax relief for those affected by the repair costs of their water-damaged home. The Minister Responsible for CMHC, Mr. Gagliano, in his news release on November 17, 1998 and letter to the Minister of Municipal Affairs of BC on November 27, 1998 stated:

The Government of Canada is of the view that provision of federal tax relief would raise serious equity and administrative issues. Furthermore, allowing owners of water-damaged homes in BC to deduct the costs of repair for income tax purposes and exempt from the GST would be unfair to other homeowners whose homes may also be in need of repair but who would be denied similar exemptions. The Government of Canada must be mindful of fairness to all Canadian taxpayers.

*- CMHC Letter to the Commission
October 4, 1999*

In response to one BC homeowner, the federal Minister of Finance, the Honourable Paul Martin, on behalf of the government of Canada stated that:

...providing tax relief as recommended by the Commission would raise serious equity and administrative issues. Allowing owners of water-damaged dwellings in BC to deduct the costs of repair and avoid sales

² Press Release, Revenue Canada, Taxation of Financial Assistance to Manitoba Flood Victims, June 17, 1997

taxes would be unfair to other homeowners whose homes may also be in need of repair and who would be denied this treatment.

In addition, it would be very difficult to justify special tax treatment for unexpected repair costs in some circumstances (such as water damage), and not in others. As you no doubt know, similar proposals for tax relief were put forward in the wake of the Saguenay and Manitoba floods, as well as the Quebec/Ontario ice storm. As you stated, in those circumstances, many homeowners experienced similar costs to those of owners of water-damaged BC homes. In all of these cases, the federal government cooperated with the provinces in providing direct financial assistance to victims. However, it was recognized that the tax system, which is designed to apply to all taxpayers in equal measure, is not the proper tool to provide relief in these unique situations.

*- Letter to William Wahl from Honourable Paul Martin
August 26, 1999*

Accordingly, the Commission's recommendations on GST exemptions (and refunds for repair renovations already paid) and equal treatment for homeowners who rent and those who reside in their own homes, have been turned down by the federal government.

The provincial government announced on June 28, 1999 that it would provide a provincial sales tax (PST) relief grant for repair costs to leaky homes. However, the PST relief grant applies only to eligible repairs completed on or after July 28, 1998--the date of the proclamation of the Homeowner Protection Act, which unfortunately, provides no assistance to many homeowners who undertook repairs before that date. As some presenters so aptly pointed out, the people who brought the need for this financial support forward at the first Commission hearings, ended up not being able to benefit from the recommendation.

Recommendation #73: CMHC, through the Canadian government, immediately double the amount of funding to BC's RRAP program and maintain funding levels for homeowners affected by building envelope failures, according to qualified demand.

Recommendation #74: Candidates qualify, both prior to and subsequent to, repairs being undertaken, as long as the repairs are a function of special assessments, related to the leaky condo problem.

On December 18, 1998, the Honourable Herb Dhaliwal, Minister of National Revenue announced, on behalf of the Honourable Alfonso Gagliano, that the Government would provide additional funds for housing renovation programs for low-income Canadians.

This included an additional \$2.3 million in Residential Rehabilitation Assistance Program (RRAP) funding for BC homeowners in the 1998/99 fiscal year. This program is expanded to be used by eligible condominium owners to help with the costs of repairing

moisture-damaged units. Recently, the federal government announced a further increase in funding as part of its strategy to help alleviate homelessness across Canada.

RRAP has a number of sub-programs including Homeowner RRAP, Rooming House RRAP, RRAP for Disabled Persons, Rental RRAP, Emergency Repair Program (ERP), and Housing Adaptations for Seniors Independence (HASI).

With respect to the leaky condo problem, the Homeowner RRAP is the most relevant of the programs and works to provide assistance to low income homeowners in bringing their properties up to minimum levels of health and safety standards. Assistance is in the form of a loan--part of which may not have to be repaid. To qualify, a household's income must be below a maximum established for the applicable area. In southern areas of BC, the maximum loan is \$18,000; in northern areas, \$21,000; and for far northern areas, \$27,000. The maximum amount which may be forgiven varies from \$12,000 in the south to \$18,000 in the far northern areas. The amount of forgiveness depends on household income, and is based on a percentage of the repair costs covered under the program. Maximum forgiveness is available where the household income is 60 percent or less of an income threshold for a certain area.

In discussion with CMHC, there have been very few applications identified as leaky condos. However, the expanded funding for this program will be fully utilized by BC homeowners by the end of the fiscal year. One of the problems facing some homeowners when applying for RRAP assistance is that CMHC decides whether or not the repairs can be satisfactorily completed and, if not, funding is refused. For example, one group of about 10 seniors in a building with repair needs, but without special assessments, applied to RRAP. They were refused because they did not have a special assessment, engineer's report, or sufficient income to solve the entire problem.

Another problem with RRAP was that the repairs were to be completed within six months. For many leaky condo problems, this is an unreasonably short time frame. In December 1999, this requirement was waived.

RRAP will not advance monies until the job is 50 per cent complete. The current waiting list (2.5 years in Victoria, for example) makes the program impractical for condo owners who often have no control over the timing of the repairs, since it is a strata corporation decision.

The federal government and CMHC have not made RRAP grants retroactive because, as noted, the program applies to a much broader constituency than just leaky condos and retroactivity can not be applied selectively.

Recommendation #51: Financial Institutions operating in British Columbia be requested to contribute on a pro rata basis, based on their residential mortgage portfolio, \$10 million to the Reconstruction Fund.

The provincial Reconstruction Fund has been designed to assist those people most in need of financial support and as a last source of financing prior to forcing a foreclosure. The major beneficiary of the Reconstruction Fund is the homeowner faced with the loss of property. As well, when a homeowner accesses Reconstruction Fund financing, other strata council members benefit because repairs can be affected without waiting for the sale of the unit which would be required if a foreclosure was triggered. This expeditious approach to financing special levy shortfalls supports the residential construction market, since property values are not eroded as far as they would be in the absence of the fund. Also, units available for sale are fewer than would be the case if the Reconstruction Fund was not available.

However, the other main beneficiaries of the provincial Reconstruction Fund are the banks, credit unions, trust companies and other financial institutions who hold the first mortgage on the property and avoid costly and unpredictable foreclosure activity because the Fund is available to homeowners. If the mortgage is insured--which approximately 40-50 percent are--the benefit of the Reconstruction Fund flows directly to the insurer because of the avoidance of foreclosure activity.

In addition to avoiding increased loan loss ratios from foreclosed properties, financial institutions benefit from providing and administering the Reconstruction Loans, with CMHC insurance on the loans as back-up. If the homeowner defaults on the Reconstruction Loan, HPO is obligated to pay CMHC the defaulted loan amount.

Not only have the banks, credit unions, trust companies and other financial institutions benefited through reduced exposure to risk because of the existence of the Reconstruction Fund, they have expanded their lending opportunities. Although CMHC does not charge an application processing fee or mortgage loan insurance premium payable for any Reconstruction Loan, the Crown Corporation has no exposure on the insured amounts because CMHC will be reimbursed by HPO for any claim.

There are currently 2,379 loans approved by HPO worth almost \$55.8 million. The average repair is \$23,470. If these properties had proceeded into foreclosure, the impact would have been felt by financial institutions and by CMHC. The foreclosure process is time consuming and expensive. A typical foreclosure arises when a homeowner is unable to pay their mortgage. With respect to leaky condos, the non-payment of a special levy for repairs will also trigger the foreclosure process. In a foreclosure with a special assessment, the financial institution or CMHC, if the property is insured, must pay the special levy to the Strata Corporation out of proceeds from the sale of the property. Because of the Reconstruction Fund Loan, this additional expense to the financial institution or CMHC, is avoided.

Although requested by the Commission, the chartered banks (through the Canadian Bankers Association) and the credit unions (through BC Central Credit Union) declined to

appear before the Inquiry, indicating that the “*problem was being addressed through individual relationships with their customers*”³

As noted in the first Barrett report, there were numerous oral and written presentations from condo owners and strata councils stating that financial institutions were unresponsive and insensitive to the needs of people hardest hit by the condominium crisis. This issue will be fully addressed in Volume II.

The Commission noted that if the many recommendations in its report would be implemented, this would substantially improve residential real estate market conditions, and assist many homeowners facing significant financial pressure. Since the financial institutions would benefit, the Commission recommended that there be a nominal financial contribution from them in the amount of \$10 million. This was not forthcoming.

The banks and credit unions reluctance to come forward and discuss the condominium crisis with the Barrett Commission has insulated them from the problem by allowing them to avoid public exposure or accountability. The credit unions have been just as reluctant as the banks to take a leadership role in ensuring foreclosures are minimized.

Recommendation #48: That CMHC and financial institutions recognize the impact of GDS ratios on consumers with a view to providing lower cost, longer amortization solutions to consumer special levy needs.

CMHC has informed the Commission that as a part of their default management system, lenders have the option of reducing the impact of the increased loan amount on borrower’s payments by extending the mortgage period.

Recommendation #71: That if a homeowner has a CMHC-approved mortgage, and faces special assessments, as a result of a leaky condo, the homeowner automatically qualifies for review under the terms of a capitalized loan balance, at current mortgage rates with no additional fee payable by the homeowner.

The Commission was informed that CMHC encourages Approved Lenders to pay particular attention to the corporation’s Default Management policies and explore all possible avenues to save the loan, with capitalization being one of the remedies available. In the event of an increased loan being approved through capitalization, no additional fee or premium is charged by CMHC.

As of October 4, 1999, CMHC had approved 50 requests for capitalization over \$10,000 per unit (up to this amount financial institutions have authority to approve, without CMHC consent) for special repair assessments because of moisture damage.

³ Renewal of Trust in Residential Construction, June 1998, page 51.

Recommendation #72: That if a homeowner does not have a CMHC-approved mortgage, and additional financing is required, CMHC should be approached for a high-ratio mortgage.

This recommendation was essentially information to homeowners facing repairs, since they may not have been aware that for many years CMHC has permitted lenders to use CMHC mortgage insurance as an avenue for existing mortgages, including improvements.

Recommendation #78: The exemption of repairs from income is a regressive benefit, in that it increasingly supports those with greater taxable income. Current property owners with high wage and salary income obtain a dollar-for-dollar benefit greater than property owners who make less in wage and salary income. For this reason, the Commission recommends access to the Reconstruction Fund for both owner/occupiers and owner/landlords.

The HPO has allowed owner/occupiers as well as owner/landlords to access the Reconstruction Fund.

Recommendation #81: A procedure be established to use the permissive exemption clause of the Municipal Act and the Vancouver Charter, whereby exemption from taxes payable be provided to all homeowners undergoing repairs related to the leaky condo problem.

Recommendation #82: That senior citizens be made aware of the opportunity to defer property tax as a means to alleviate some of the burden of the costly repairs.

The Commission is unaware of any steps taken by municipal governments to address either of these recommendations.

II. Summary

The findings of the most recent series of public hearings indicate that the collapse of NHW and the lack of financial support measures are rendering it impossible for homeowners to cope with necessary repairs. The Commission is of the view that immediate and significant direct compensation to homeowners who have faced, are facing, or will face, costs for repairs to building envelopes ruined by water ingress, is the only effective redress to this disaster. As a result, most of the financial support recommendations put forth in the first Barrett Commission report would be redundant and should be subsumed by the Compensation Plan outlined in Chapter THREE.

APPENDIX II

PROVINCE OF BRITISH COLUMBIA

ORDER OF THE LIEUTENANT GOVERNOR IN COUNCIL

10/199
13:55
Order in Council No.

1055

Approved and Ordered AUG 11 1999

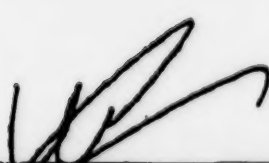


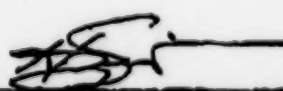
Lieutenant Governor

Executive Council Chambers, Victoria

On the recommendation of the undersigned, the Lieutenant Governor, by and with the advice and consent of the Executive Council, orders that

- 1 A Commission be issued under the Great Seal pursuant to section 8 of the *Inquiry Act* appointing David Barrett a sole commissioner to inquire into and report on the matters and in the manner set out in the attached Terms of Reference.
- 2 The entitlement to reimbursement for living and travelling expenses incurred by the commissioner appointed under section 1 is equivalent to the entitlement approved by Treasury Board for Managerial employees in Group III.
- 3 Consent is given to the commissioner to appoint clerks and stenographers the commissioner considers necessary for the conduct of the inquiry, and to pay them at rates or salaries that are equivalent to the rates or salaries paid to employees in similar positions in the public service.
- 4 To assist in achieving the objectives of the inquiry, the commissioner may appoint or retain counsel, research assistants and professional advisors that the commissioner considers appropriate and the rates, fees and expenses applicable to these appointees will be those established by the Attorney General.
- 5 The commissioner shall receive \$725 for each day spent in the work of the inquiry.


Minister of Social Development and Economic Security


Presiding Member of the Executive Council

(This part is for administrative purposes only and is not part of the Order.)

Authority under which Order is made:

Act and Section:- *Inquiry Act*, section 8

Other (specify):- o.c. 607/96

August 11, 1999

796/993244
1153/99/13/14

A Further Inquiry into the Quality of Condominium Construction in British Columbia

TERMS OF REFERENCE

- 1 To further inquire into the quality of condominium construction in British Columbia and, in particular, the adequacy of protection for, and accountability to, consumers for faulty condominium construction.
- 2 To inquire into the impacts on homeowners, the housing market, mortgage insurers and the economy of the financial failure of New Home Warranty of British Columbia Inc.
- 3 To inquire into the extent of foreclosures, bankruptcies and related matters arising from faulty condominium construction.
- 4 To submit a report by October 29, 1993, to the Lieutenant Governor in Council through the Minister of Social Development and Economic Security, recommending any measures, including but not limited to changes to legislation, regulations or administrative practice, that the Commissioner determines are needed.

PROVINCE OF BRITISH COLUMBIA

ORDER OF THE LIEUTENANT GOVERNOR IN COUNCIL

Original Council No.

1238 , Approved and Ordered SEP 10 1999



Lieutenant Governor

Executive Council Chambers, Victoria

On the recommendation of the undersigned, the Lieutenant Governor, by and with the advice and consent of the Executive Council, orders that the Terms of Reference attached to order in council 1055/99 are amended

(a) by adding the following section:

2.1 To inquire into the history of home warranties in British Columbia and the causes of the failure of New Home Warranty of British Columbia, Inc., and

(b) in section 4 by striking out "by October 23, 1999," and substituting "by January 15, 2000,".



President of the Executive Council

(This part is for administrative purposes only and is not part of the Order.)

Authority under which Order is made

Act and section: Inquiry Act, section 8

On at (specify):

September 10, 1999

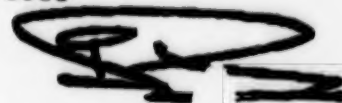
1293/99/13/sak

TOTAL P.02

TOTAL P.01

PROVINCE OF BRITISH COLUMBIA
ORDER OF THE LIEUTENANT GOVERNOR IN COUNCIL

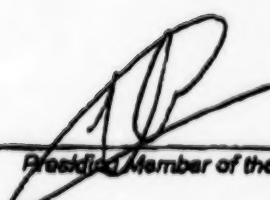
2 , Approved and Ordered JAN 13 2000



Lieutenant Governor

Executive Council Chambers, Victoria

On the recommendation of the undersigned, the Lieutenant Governor, by and with the advice and consent of the Executive Council, orders that the Terms of Reference attached to order in council 1055/99 are amended in section 4 by striking out "by January 15, 2000," and substituting "by March 10, 2000,".



Presiding Member of the Executive Council

(This part is for administrative purposes only and is not part of the Order.)

Authority under which Order is made:

Act and section:- Inquiry Act, s. 8

Other (specify):-

January 6, 2000

1966/99/16/cac